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IN THE

Supreme Court of the United States

OCTOBER TERM, 1969

Nos. 914, 915, 916, 917, 920, 921, 1038 and 1057

THE NEW HAVEN INCLUSION CASES

ON APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK AND ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT BEFORE JUDGMENT

BRIEF FOR PENN CENTRAL TRANSPORTATION COMPANY, APPELLEE—RESPONDENT—CROSS-PETITIONER

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March 18, 1970

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BRIEF FOR PENN CENTRAL TRANSPORTATION COMPANY, APPELLEE—RESPONDENT—CROSS-PETITIONER

Preliminary Statement

This is a consolidated proceeding involving three direct appeals—Nos. 915, 917 and 921—by representatives of the bondholders* of The New York, New Haven and Hartford Railroad Company (the "bondholders" and the "New Haven", respectively) from the Three-Judge United States District Court for the Southern District of New York ("Three-Judge Court") and petitions for writs of certiorari, filed by the bondholders—Nos. 914, 916 and 920, Penn Central Transportation Company** ("Penn Central")—

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* The following abbreviations are used herein to designate the representatives of the bondholders: The Chase Manhattan Bank, N. A. ("Chase"); the First Mortgage 4% Bondholders Committee ("Committee"); and Manufacturers Hanover Trust Company ("Mfrs.").

** "Penn Central Transportation Company" is the present name of The Pennsylvania Railroad Company ("Penn") into which The New York Central Railroad Company ("Central") was merged.

No. 1038, and the United States and Interstate Commerce Commission (the "Commission")—No. 1057, to the United States Court of Appeals for the Second Circuit before judgment in that Court to review the issues raised by the orders of the United States District Court for the District of Connecticut ("Reorganization Court").

By order dated February 2, 1970, this Court noted probable jurisdiction in Nos. 915, 917 and 921, granted certiorari in Nos. 914, 916, 920, 1038 and 1057, and consolidated the proceedings for argument, on an expedited schedule.

Questions Presented

1. Did the Reorganization Court improperly assume the valuation function assigned to the Commission by Section 77(e) of the Bankruptcy Act and disregard established standards of judicial review by substituting its own views for the Commission's determinations with respect to the following issues:

> (a) Whether, in determining a realistic liquidation value for the New Haven, recognition should be given to the economic consequences of the time required for abandonment proceedings before the Commission and the courts;
>
> (b) Whether, in determining the liquidation value of the New Haven land on the valuation date, recognition should be given, in economic terms, to the risks which would thereafter be incurred in a minimum six-year marketing program;
>
> (c) The probable scope of future rail service to the New Haven's freight yards in the Bronx if the New Haven were liquidated; and

(d) The calculation of the discount of liquidation proceeds to present worth?

2. Did the Reorganization Court err in concluding that constitutional and statutory barriers exist to the Commission's method of determining the liquidation value of the New Haven?

3. Did the valuation findings in the Commission's Fourth Supplemental Report, as modified and affirmed by the Three-Judge Court, have a reasoned basis in substantial evidence, and are they consistent with applicable statutory standards?

Statutes Involved

Section 5(2)(d) of the Interstate Commerce Act, 49 U.S.C. §5(2)(d), and Section 77(e) of the Bankruptcy Act, 11 U.S.C. §205(e), provide in part as follows:

Section 5(2)(d)

"The Commission shall have authority in the case of a proposed transaction under this paragraph (2) involving a railroad or railroads, as a prerequisite to its approval of the proposed transaction, to require, upon equitable terms, the inclusion of another railroad or other railroads in the territory involved, upon petition by such railroad or railroads requesting such inclusion, and upon a finding that such inclusion is consistent with the public interest."

Section 77(e)

* * *

"If it shall be necessary to determine the value of any property for any purpose under this section, the Commission shall determine such value and certify the same to the court in its report on the plan. . . ."

Other relevant statutory provisions are printed in the "Appendix of Decisions and Constitutional and Statutory Provisions" (App. 453-65a).*

Statement of the Case

Background of inclusion

By application filed with the Commission on March 9, 1962, Penn and Central sought authority, under Section 5(2) of the Interstate Commerce Act (the "Act"), 49 U.S.C. §5(2), to merge.

On June 26, 1962, the Trustees of the New Haven (the "Trustees")** intervened in the merger proceeding and, pursuant to Section 5(2)(d) of the Act, petitioned for inclusion of the New Haven in the proposed merged company, asserting that the Penn and Central merger constituted a threat to the viability of the New Haven's operations. See *In re New York, N.H.&H.R.R.*, 378 F.2d 635, 636 (2d Cir. 1967). The Trustees testified in the merger proceedings that it would be appropriate for the Commission to condition inclusion upon the attainment of financial viability by the New Haven, and referred to this requirement as their "duty to streamline the New Haven system [so] that its continued operation will at least break even". (Merger Transcript, p. 9252; see *id.* at 9313, 9438.)

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* This Appendix was filed by the bondholders on December 5, 1969 with their jurisdictional papers; a second Appendix, the "Appendix of Significant Dates and Excerpts from the Record", was filed on February 26, 1970, with the bondholders' briefs. Herein, both Appendices will be referred to with the prefix "App."; the letter following the page number will designate the Appendix referred to, as all pages in the Appendix of Decisions are followed by the letter "a" and the pages of the Appendix of Significant Dates and Excerpts from the Record are followed by the letters "b" and "c".

** The New Haven reorganization began on July 7, 1961, when a petition under Section 77 of the Bankruptcy Act was filed with the Reorganization Court and the Commission.

Commission hearing examiners (the "Examiners") held hearings on the proposed merger and inclusion from August 20, 1962 to October 2, 1963. In a brief filed with the Examiners in June, 1964, Penn and Central for the first time indicated willingness to take the New Haven's freight operations on some form of lease basis. As a result, at the Trustees' suggestion, negotiations with respect to the freight service were commenced between the Trustees and representatives of Penn and Central on June 16, 1964. Although an initial understanding was reached on November 9, 1964 (App. 19-22c), the negotiations continued throughout 1965 and into 1966; a formal agreement (the "Purchase Agreement") was not executed until April 21, 1966. The Purchase Agreement related solely to the acquisition of the New Haven's freight operations by Penn Central.

On April 27, 1966, six days after execution of the Purchase Agreement, the Commission served a Report which approved the Penn and Central merger, but, in "Condition 8", modified the inclusion terms recommended by the Examiners* to impose upon Penn Central the additional burden of taking over New Haven's passenger operations, such inclusion to be "upon such fair and equitable terms as the parties may agree", subject to the approval of the Commission and the Reorganization Court. 327 I.C.C. 475 at 553.

On October 4, 1966, by amendment of the Purchase Agreement, Penn and Central agreed to take on the huge passenger deficits of the New Haven without any reduction in the price stated in the Purchase Agreement.

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*On March 29, 1965, the Examiners issued a Report which concluded that Penn Central should not be saddled with the New Haven's passenger burdens. (Examiners' Report, pp. 412-13.) Accordingly, on October 11, 1965, the Trustees filed with the Commission an application to discontinue all interstate passenger trains, effective March 1, 1966. On April 27, 1966, the same day that the Commission approved the Penn and Central merger, it served a second Report denying in part the Trustees' application. 327 I.C.C. 151.

Initial valuation proceedings before the Commission and the reviewing courts

On October 27, 1966, the Trustees, Penn and Central petitioned the Commission for approval of the inclusion terms in the Purchase Agreement, as amended, pursuant to Section 5(2)(d) of the Act and Section 77 of the Bankruptcy Act, 11 U.S.C. §205.

The Commission heard evidence from January 16 to May 12, 1967, principally on issues relating to valuation of the New Haven.* The transcript of the hearings contains over 5,000 pages, and 141 documentary exhibits were introduced into evidence.**

The Commission served its Second Supplemental Report and Order (the "Inclusion Report") on November 21, 1967, concluding that the Purchase Agreement's terms constituted "equitable terms" for inclusion within the meaning of Section 5(2)(d) of the Act and "fair and equitable terms" for the sale of the New Haven's assets within the meaning of Section 77. The Commission found that the consideration to be paid to the New Haven under the Agreement gave the New Haven Estate the approximate equivalent of the liquidation value of the New Haven assets being conveyed to Penn Central.

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* While the Commission's hearings were in progress, by cross-petition dated April 26, 1967, one group of bondholders, the Committee, sought termination of the reorganization proceedings and liquidation of the New Haven. This was the first (and only) such petition filed by the New Haven bondholders. The Reorganization Court dismissed the Committee's cross-petition on February 13, 1968. *In re New York, N.H.&H.R.R.*, 281 F. Supp. 65 (D. Conn. 1968), App. 229a. The Committee filed an appeal but did not prosecute it.

** These exhibits are designated by the prefix "NHI- ". "T." refers to the consecutively-numbered pages of the transcript of hearings before the Commission (both to the original hearings and to the hearings on remand), which is part of the record before this Court. For the Court's convenience, there is set forth as Appendix "A" to this brief a Cross-Reference Table which will facilitate the location of these exhibits and transcript pages, to the extent they are not reproduced in the printed appendix, in the record certified to this Court on the appeals from the Three-Judge Court.

Although the Commission said that it knew of no legal requirement that would compel Penn Central to absorb pre-inclusion losses of the New Haven, on grounds of fairness it required Penn Central to lend operating funds to the New Haven and to absorb a portion of the New Haven's operating losses during the period between the consummation of the Penn and Central merger and the New Haven's inclusion. 331 I.C.C. at 704, 715-16, App. 73-74a.

In 1967 and 1968, parties who objected both to the merits and to the prompt consummation of the Penn and Central merger sought judicial review of the Commission's orders approving the merger. It was not until January 15, 1968, when this Court rendered its decision in *Penn-Central Merger and N&W Inclusion Cases,* 389 U.S. 486 (1968), that doubts as to whether the Penn and Central merger would occur were finally resolved. Penn and Central merged on February 1, 1968.

Thereafter, the Three-Judge Court, acting pursuant to jurisdiction conferred by 28 U.S.C. §§1336(a) and 2321-25, and the Reorganization Court, acting pursuant to Section 77, concurrently reviewed the Commission's Inclusion Report.

On July 10, 1968, the Three-Judge Court, and on August 13, 1968, the Reorganization Court,* found that the Commission had understated the New Haven's liquidation value and overstated the value of the consideration to be paid by Penn Central, and remanded the case to the Commission. In its opinion, the Reorganization Court stated that the bondholders could not constitutionally be required to bear the operating losses of the railroad after December 31, 1968, and warned that the Court would order the New Haven to be shut down on January 1, 1969, unless the Com-

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* The Three-Judge Court opinion is reported at 289 F. Supp. 418 (S.D.N.Y. 1968) and the Reorganization Court opinion at 289 F. Supp. 451 (D. Conn. 1968); the opinions are printed at App. 323-83a, and 237-60a, respectively.

mission required Penn Central to commence operating the New Haven not later than such date, with the price to be paid for the New Haven and authority to abandon to be determined later. 289 F. Supp. at 458-59, App. 245a.

Remand proceedings before the Commission and the Commission's Fourth Supplemental Report

Pursuant to the orders of the reviewing courts, the Commission conducted a second round of hearings in October, 1968, again dealing principally with valuation issues. Both Penn Central and the bondholders offered evidence. Of the 46 documentary exhibits marked for identification, 41 were received in evidence,* and 26 witnessses were cross-examined.**

Both reviewing courts had indicated that on remand the Commission should have flexibility in the application of the guidelines set forth in the courts' opinions. 289 F. Supp. at 441, App. 361a; 289 F. Supp. at 454, App. 239a. In addition to offering evidence dealing with certain valuation issues which had been specifically remanded, Penn Central also offered testimony relating to the following matters:

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* The five documentary exhibits offered but excluded contained testimony submitted by Penn Central. Exhibits at the remand hearings are identified by the prefix "R- ". To the extent these exhibits are not reproduced in the printed appendix, see the Cross-Reference Table in Appendix "A" to this brief as to their location in the Three-Judge Court record.

** Testimony taken and 40 documentary exhibits received by the Special Master appointed by the Reorganization Court were also made part of the record before the Commission. In April, 1968, the Reorganization Court had appointed the Honorable John Van Voorhis, recently retired from the Court of Appeals of the State of New York, as Special Master and asked him to describe the "nature of the legal interests of the New Haven" in the Grand Central Terminal properties. 289 F. Supp. at 463, App. 252a. Judge Van Voorhis held nine days of hearings, took extensive evidence and filed two reports on June 17, 1968 ("Spec. M. Rep.", App. 253-92c) and July 22, 1968 ("Spec. M. Supp. Rep.", App. 293-322c), relating to these properties. The Reorganization Court agreed with, and "adopted", the Special Master's conclusions as to the New Haven's legal interests. 289 F. Supp. at 463, App. 252a.

1. Evidence relating to the economic consequences of the time required for abandonment proceedings before the Commission and the courts.

2. Testimony of an expert on the purchase and sale of large-scale land areas, showing that the individual appraisals of over 3,000 parcels of land owned by the New Haven, introduced at the initial inclusion hearings, did not reflect the fair market value of the land on the valuation date because those appraisals, even as adjusted by a 6% discount to present worth and discount in the final two years for specific unsaleable parcels, did not reflect adequately the risks of a post-valuation date marketing program for such land.

3. Evidence demonstrating that, in contrast to the portrait painted by the bondholders of declining values of bondholder investments throughout the reorganization, there had been considerable speculation in the New Haven's first and second mortgage bonds which had been rewarded with increasing market prices for the bonds.*

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* This evidence showed an unusually high turnover rate for the first mortgage and income bonds during the reorganization (R-34 and R-36), and also showed that holders of New Haven bonds had actually experienced a substantial increase in the value of the bonds over the value immediately prior to the reorganization. In the twelve-month period prior to the New Haven's reorganization (July, 1960 through June, 1961), the New Haven's bonds sold in the following ranges: First Mortgage bonds, high 34 and low 22¾, General Income bonds, high 13½ and low 9⅛. (See R-34, Schedules 1 and 2.) In contrast, at the close of 1968, the New Haven's First Mortgage bonds closed at 55, and the General Income bonds closed at 17⅞, on the New York Stock Exchange. *The New York Times*, January 1, 1969, p. 34.

Exhibit R-35, an affidavit of Oscar Gruss (the New Haven's largest single bondholder—see 389 U.S. at 509), dated July 6, 1965, illustrates the increase in the market value of the bonds. Gruss's First Mortgage bonds, purchased at an average net cost of $27, and his Income bonds, purchased at an average net cost of $9.70, had, by the time of the remand hearings, doubled in value. Confirmation of this evidence seems apparent from the fact that on June 24,

In its Fourth Supplemental Report of November 25, 1968 ("Remand Report"), the Commission carefully re-examined areas delineated by the reviewing courts and made numerous changes in its valuation findings. Whereas the Commission had, in the Inclusion Report, valued the agreed consideration at approximately $125 million, the Commission concluded on remand that the purchase consideration to be paid by Penn Central should be increased to $145.6 million. This included $5 million of loss sharing (*i.e.*, of pre-inclusion New Haven losses) for the period from February 1, 1968 through December 31, 1968.

In the Remand Report, the Commission found that if the appraisals of the various categories of New Haven assets made as of December 31, 1966* were added together, on the assumptions that on that date the New Haven could immediately shut down and that the land pricing was to be on a parcel-by-parcel basis, the resulting "net liquidation value" of the New Haven would be $162.7 million. 334 I.C.C. at 53, App. 140a. But the Commission found that, in valuing what the New Haven Estate might actually have received if it had pursued the liquidation alternative, it had to consider the economic consequences of: (1) a minimum one-year delay that would have occurred before the start of the New Haven's liquidation, due to the need for obtaining a certificate of abandonment, and (2) the risks (not reflected in the Inclusion Report valuation) flowing from the minimum six-year marketing program for the sale of 3,000 separately appraised parcels of New Haven land.** The pricing out of these economic

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1969 Oscar Gruss, through his counsel, asked leave of the Reorganization Court to withdraw from this litigation; on that date the bonds closed at 50⅜ and 13⅜, respectively.

* Most of the appraisals were actually made as of December 31, 1965, but were carried forward by the Commission to a valuation date of December 31, 1966.

** The Commission indicated that in 1967, in the Inclusion Report, it only had to "appraise the fairness of the purchase agreement price then available for use" (334 I.C.C. at 53, App. 140a); in the Remand Report, however, the Commission had to proceed further in its analysis and actually appraise the realistic liquidation value of the New Haven.

consequences led the Commission to conclude that the New Haven's realistic liquidation value on the valuation date was $22.1 less than the $162.7 figure, or $140.6 million.

December 31, 1968 inclusion

Responding to a threatened shutdown of the New Haven's operations by the Reorganization Court on January 1, 1969 (see 289 F. Supp. at 458-59, App. 245a), the Commission also ordered Penn Central to take over the New Haven's operations no later than that date and concurrently to pay the increased purchase price.

Penn Central attempted to obtain review of the Commission's price determination by the Reorganization Court in advance of the January 1 take-over date, but that Court declined to undertake such prior review by an order dated December 24, 1968.* Penn Central appealed this order and, in addition, sought a stay of the Commission's take-over order in the Three-Judge Court, asserting that Reorganization Court's approval of the price was a necessary condition precedent to the transfer of the assets. The stay was denied.** The Three-Judge Court said, unanimously, that "our study of the [Commission's] report on remand indicates a thorough and conscientious effort by the Commission to follow the directions with respect to the determination of liquidation value made by the Reorganization Court and ourselves". The Court noted that the Commission by its efforts had seemingly narrowed the range of "true controversy" over the price. (App. 392-93a.)

Inclusion took place on December 31, 1968. No bondholder objected to the transfer of the assets. As of December 31, 1968, the annual deficit in the New Haven's net

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* The Reorganization Court's order and accompanying opinion are not reported but are set forth at App. 263-76a.

** This denial was in the form of an oral opinion which is not reported, but the transcript of the opinion is set forth at App. 387-93a.

railway operating income had increased, from about $10 million at the time of the commencement of the negotiations for the acquisition of the New Haven, to approximately $20 million.* 289 F. Supp. at 458, App. 243-44a. Although, at the time of the initial agreement, Penn Central had agreed to assume only the burden of the New Haven's annual freight deficits, which amounted to about $6.5 million in 1964 and 1965, the Commission's imposition in April, 1966 of the passenger burden had added about $10 million per year to the deficits Penn Central was required to assume. (NHI-30 (Table 5).)** Additionally, by the end of 1967, before the date of inclusion, the New Haven's annual freight deficits had increased to about $10 million.***

In late December, 1968 and early January, 1969, the bondholders filed objections and complaints with the reviewing courts addressed to the Commission's Remand Report. Penn Central also appealed from the Commission's determination, asserting that the valuation of the New Haven was "excessive" and "unduly favorable to the New Haven Estate". The Reorganization Court and the Three-Judge Court again concurrently reviewed the Commission's price determination.

The Three-Judge Court sustained the Commission's Remand Report with modifications which again increased the purchase consideration payable by Penn Central, by about $1 million; in addition, the Court held that Penn Central should pay the New Haven $3.38 million as its share of the amount by which the income from the G.C.T. properties exceeded the Terminal's expenses in 1967 and

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* Moreover, this loss was computed after subtraction of State aid and tax relief of about $10 million a year. (NHI-71, pp. 7-8; T. 27842.) Since the inclusion, State aid and tax relief for the New Haven line have been decreased from the pre-inclusion level.

** As heretofore noted, the imposition of the passenger burden caused no decrease in the agreed price.

*** Report of New Haven Trustees for 1967 to Judge Anderson, filed March 29, 1968, p. 5671.

1968. 305 F. Supp. 1049, App. 400-43a. As a result, Penn Central was required to pay a sum of approximately $150 million.* The Reorganization Court, however, took issue with the Commission's findings as to the New Haven's liquidation value and, applying that Court's own views as to the proper method of determining the liquidation value of the New Haven, increased the purchase price by approximately $28.5 million over and above the price as adjusted by the Three-Judge Court. 304 F. Supp. 793, App. 277-306a.

The conflict between the opinions of the Three-Judge Court** and the Commission, on the one hand, and the opinion of the Reorganization Court, on the other, is attributable to the following:

	Further Price Increase Sought to be Imposed on Penn Central by the Reorganization Court
1. Refusal of the Reorganization Court to permit the Commission (in its valuation of the New Haven assets upon a liquidation assumption) to take account of the economic consequences of the delay inherent in the statutorily-mandated abandonment proceedings	$15,386,000
2. Refusal of the Reorganization Court to accept the Commission's recognition, in dollar terms as supported by expert testimony, of the risks inherent in conducting a long-term marketing program for over 3,000 parcels of New Haven land	6,695,000

* The Commission, in its Fifth Supplemental Report, as modified, and Order, made supplemental findings consistent with the Three-Judge Court opinion. The Report and Order are reported at 334 I.C.C. 528 and are printed at App. 222-28a. Penn Central took no appeal from the Three-Judge Court decree.

** Judge Weinfeld dissented from the decision of the Three-Judge Court. See 305 F. Supp. 1049 at 1065, App. 431-43a.

	Further Price Increase Sought to be Imposed on Penn Central by the Reorganization Court
3. Substitution by the Reorganization Court of its own views, for those of the Commission, as to the probable scope of rail service to the New Haven's freight yards in the Bronx of New York after New Haven liquidation.....	$4,439,000
4. Substitution by the Reorganization Court, upon settlement of its decree, of the bondholders' recalculation of the discount of liquidation proceeds to present worth for the Commission's determination of such discount	2,005,899

Both the Three-Judge Court and the Reorganization Court reaffirmed the Commission's adherence to its $87.50 per share valuation of Penn Central's stock,* but developed an underwriting formula which gives the New Haven a cash guaranty of the opportunity to realize $87.50 per share over an eight-year period. This guaranty goes beyond providing that the New Haven will receive the difference between $87.50 per share and the market value of the Penn Central stock at the date of inclusion; it is so framed that, if the Penn Central stock remains below its market price on the inclusion date, the New Haven will receive the difference between that lower price and $87.50 per share.

As to all other valuation issues raised by the bondholders in this Court, each Judge of the Three-Judge Court

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* The Reorganization Court's decree of July 28, 1969 specifically found the "value of the 950,116 shares of common stock delivered by Penn Central on December 31, 1968 to the Debtor is $83.1 million" (*i.e.*, $87.50 per share), subject to the underwriting provisions. App. 318a; see 304 F. Supp. at 809, App. 299-300a. The Three-Judge Court said that its views "parallel those recently expressed by the reorganization court." 305 F. Supp. at 1064, App. 429a.

and the Reorganization Court voted to affirm the findings of the Commission.*

Summary of Argument

The ultimate issue here is whether the Commission's evaluation of the New Haven's properties has a reasonable basis in findings that are supported by substantial evidence. The Three-Judge Court reviewed the Commission's findings and held that they should be sustained under the standards of review established by this Court. The Reorganization Court, in contrast, disregarded Section 77(e) of the Bankruptcy Act, which commits the function of valuation to the Commission, and the standards of review established by this Court under Section 77(e), and improperly substituted its judgment for that of the Commission on valuation issues. Appellants' argument that this Court should disregard the standards of review established by its own decisions and make a *de novo* appraisal of the evidence should be rejected. The Commission did not, as appellants argue, depart from the standard of liquidation value but on the contrary determined a realistic liquidation value. The Commission's findings on that value have a reasonable basis in, and are supported by, substantial evidence and should be affirmed.

I

The Commission properly determined that in fixing a liquidation value for the New Haven properties an allowance should be made for the delay and costs that the New Haven would incur in obtaining an abandonment certificate under Section 1(18) of the Interstate Commerce Act. Appellants do not deny that in an actual liquidation the New Haven would incur the delay and costs. There is no merit in their argument that it was unfair to apply this realistic test of liquidation value because of the operating losses that the New Haven had incurred while it was seeking inclusion in Penn Central. The New Haven and its bondholders voluntarily chose to pursue the course

* Judge Weinfeld did, however, disagree with the other Judges on the issue of loss sharing from February 1, 1968 to the inclusion date. 305 F. Supp. at 1070, App. 442a.

of inclusion in their own self-interest and in the belief that the standard of liquidation value would be advantageous to them, as indeed it is, and they cannot now legitimately complain because liquidation value has been determined on a realistic basis. Their fairness argument ignores the facts that Penn Central is being required to assume the New Haven operating losses for the indefinite future, that Penn Central cannot realize upon the liquidation values which it is being asked to pay, and that it would be unfair and unreasonable to determine a liquidation value that ignores restrictions on liquidation that exist in law and fact.

The Commission's finding that abandonment proceedings would mean at least a year's delay before liquidation sales could begin is reasonable since in any such proceeding the claims of states, other governmental agencies and the shipping public would have to be heard and considered before the Commission could issue an abandonment certificate. Furthermore, because of the Commission's experience, its determination of the time required for such a proceeding is entitled to particular weight. The Commission's findings with respect to the dollar effects of the year's delay are supported by specific evidence and should be accepted.

II

There is a rational basis in the record for the Commission's finding that the determination of the realistic liquidation value of the New Haven land required an increased discount to reflect the risks involved in a six-year marketing program. There was expert evidence that the value of the New Haven real estate as of the valuation date could not accurately be measured by the sum of separate appraisals of more than 3,000 parcels. These appraisals were made without regard to the fact that the parcels, primarily because of the problem of market absorption, would have to be marketed over a six-year period and were made without regard to the risks involved in the extended liquidation program. This evidence demonstrated a method by which a discount could be determined that would make due allowance for the risks and uncertainties involved in the six-

year marketing program.. The method is consistent with legal canons of valuation and applies a method of analysis that rests upon accepted principles of real estate economics; its validity does not turn on the existence of an actual bulk sale or the existence of an actual bulk purchaser.

III

The record fully supports the Commission's acceptance of an appraisal of two freight yards in the Bronx which did not assume continued rail service to the yards. Upon liquidation of the New Haven it would no longer provide rail service to the yards. There was substantial evidence that, if the New Haven were liquidated, Penn Central would not serve and could not be compelled to serve the yards, and that they would not be served by any other rail carrier. Indeed, there was no credible or persuasive testimony to the contrary. In the face of the record, it was error for the Reorganization Court to substitute its judgment for that of the Commission and to adopt an appraisal that assumes the continuation of the same rail service provided by the New Haven prior to liquidation.

IV

Appellants' objection to the Commission's discount of liquidation receipts is not timely and should be rejected under the well-established rule that an attack on the action of an administrative agency should be made in the first instance to the agency while it still has an opportunity to consider its merits. Although in a position to do so, appellants did not raise their objection before the Commission either three years ago in the initial inclusion hearings or in the remand hearings. Similarly they failed to raise the objection before the reviewing courts in the two hearings on the substance of the Commission's order, but instead first raised it in 1969 on the settlement of the order of the reviewing courts. In these circumstances, the Three-Judge Court properly refused to consider the objection. *United States* v. *L. A. Tucker Truck Lines, Inc.*, 344 U.S. 33, 36-37 (1952). The rule that objections to administrative action

must be made in a timely fashion so that the agency can consider them is peculiarly applicable here because acceptance of appellants' claim of prejudice requires the appraisal of conflicting testimony with respect to the timing of liquidation receipts.

V

The other points raised by appellants were properly rejected by both the lower courts and their action should be affirmed. Appellants' attack on the Commission's determination of the inherent value of the Penn Central stock is supported by substantial evidence. Appellants' attack on the valuation is an attempt to give overriding importance to temporary market value, as opposed to inherent worth, and disregards the valuation provisions of Section 77(e). The underwriting formula adopted by both courts below and accepted by the Commission assures the New Haven the opportunity to realize at least the inherent value of the stock found by the Commission. The formula has the effect of conferring upon the Penn Central stock issued to the New Haven extraordinary protection against post-inclusion declines in the market price no matter how caused.

The claim that the New Haven should receive all of the income from the Grand Central Terminal properties unburdened by any deduction for Terminal expenses has been rejected by every tribunal that has considered the matter; it cannot be reconciled with either the provisions or the purpose of the underlying contractual arrangements between the New Haven and the Central. Appellants' alternative claim that value should be assigned to an alleged right to "free use" of the Terminal is unfounded because on liquidation this alleged right would have no value.

Appellants' argument that they are entitled to going concern value, in addition to liquidation value, was properly rejected by the courts below; appellants are not entitled to both liquidation value and going concern value because liquidation presupposes the disappearance of the

railroad as an operating entity. The cases cited by appellants do not justify a contrary conclusion. The bondholders' claim that their constitutional rights were invaded by the transfer of certain New Haven investments to Penn Central on the inclusion date is barred because they did not object to the transfer. The Commission's valuation of these assets is supported by substantial evidence. Finally, the Commission's determination that Penn Central should assume $5 million of New Haven's pre-inclusion losses in 1968 was a fair and reasonable exercise of the Commission's judgment.

ARGUMENT

Introduction

The orders under review embody the Commission's considered judgment, after remand by the reviewing courts in 1968, on the value that should be assigned to the property interests of the New Haven Estate both for the purposes of the bankruptcy proceeding and for the purposes of prescribing terms for the inclusion of the New Haven in Penn Central that will be "just and reasonable" and "equitable" as required by Section 5(2)(b) and (d) of the Interstate Commerce Act. The Commission made this judgment after appraising the voluminous evidence gathered at extensive hearings in 1967 and 1968;* after having the benefit of detailed and lengthy briefs from the parties; and after considering the views of both reviewing courts and making "a sincere effort to comply with the tasks both courts assigned it on remand."**

The Three-Judge Court held that, with certain modifications subsequently adopted by the Commission, the Commission's judgment on the valuation of the New Haven should be sustained because it had a reasonable basis in

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* In addition to the hearings before the Commission, there were two hearings before the Special Master appointed by the Reorganization Court, which were devoted to the valuation of the New Haven's interest in the Grand Central Terminal properties.

** 305 F. Supp. at 1065, App. 431a.

substantial evidence and complied with the applicable statutory standards. For reasons that are stated in detail in later sections of this brief, we submit that this decision is correct and should be affirmed.

At this point, it is appropriate to refer to certain important general considerations that will serve to put the Commission's judgment on valuation in proper context.

The task that the Commission faced in making a valuation of the New Haven properties was complex and difficult. The New Haven was and is a deficit-ridden railroad with no present earnings and no prospect of earnings in the foreseeable future. It was, therefore, impossible for the Commission to follow the conventional course and use past, present and prospective earnings as a standard for valuation. In accordance with views stated by both the Reorganization Court and the Three-Judge Court, the Commission therefore adopted liquidation value as the basic standard for valuation of the New Haven properties. This meant, as the Three-Judge Court pointed out, that the Commission was required to determine what value those properties would have in "a liquidation that never happened, that in the world as we know it scarcely could have happened, and that, if it had happened, could have happened in any one of a number of equally imaginary ways. . . ."*

In any circumstances, "An intelligent estimate of probable future values . . . , and even indeed of present ones, is at best an approximation. . . . There is left in every case a reasonable margin of fluctuation and uncertainty." *Dayton Power & Light Co.* v. *Public Utility Commission,* 292 U.S. 290, 310 (1934). In this case the hypothetical character of the liquidation that the Commission was required to assume greatly increased the area in which the exercise of judgment by the Commission was not only permissible but required. While the Commission was obliged to make a determination that had a reasoned basis in substantial evi-

* 305 F. Supp. at 1056, App. 411a.

dence and accorded with the applicable statutory criteria, the very nature of the valuation problem was such that, within those limits, there was a wide area in which the Commission might make a choice among various permissible alternatives.

The differences between the two Courts below and the nature of the arguments advanced by appellants in this Court make it necessary to refer to the standards that apply to judicial review of Commission orders. In decisions interpreting and applying Section 77, this Court has repeatedly held that Congress delegated the valuation function to the Commission and that the Commission's determination of valuation should be accepted subject only to review to determine whether it is supported by substantial evidence and conforms to the applicable statutory standards. *Ecker* v. *Western Pacific R.R.*, 318 U.S. 448, 472-473 (1943); *Group of Institutional Investors* v. *Chicago, M., St. P. & P.R.R.*, 318 U.S. 523, 536, 539-42 (1943); *Reconstruction Finance Corp.* v. *Denver & R.G.W.R.R.*, 328 U.S. 495, 508, 509 (1946).

In *Ecker* this Court, after a careful analysis of Section 77 and its legislative history,* said:

> "The power of the court [the reorganization court] does not extend to participation in all responsibilities of the Commission. *Valuation is a function limited to the Commission, without the necessity of approval by the court. . . .* The function of valuation thus left to the Commission is the determination of the worth of the property valued, whether stated in dollars, in securities or otherwise. *One of the primary objects of the bill was the elimination of obstructive litigation on the issue of valuation* [footnote omitted] and the form finally chosen approached as near to that position as seemed to the

* The legislative history of the first sentence of the final paragraph of Section 77(e), which reposes in the Commission the duty of valuation "*of any property for any purpose under this section*", is conclusive as to what Congress intended as the scope of review. This legislative history is set forth in Appendix B hereto.

> draftsmen legally possible. Judicial re-examination was not considered desirable. None of the findings required of the judge under subsection (e) relates specifically to valuation. Congress apparently intended to leave the determination of valuation 'of any property for any purpose under this section' to the Commission. [footnote omitted] The language chosen leaves to the Commission, we think, the determination of value without the necessity of a re-examination by the court, when that determination is reached with material evidence to support the conclusion and in accordance with legal standards." 318 U.S. at 472-473 (emphasis added).

This Court has recently said, in connection with a review of the Commission's valuation findings under Section 5(2)(d), that "it is not for us to second-guess each step in the Commission's process of deliberation." *Penn-Central Merger and N&W Inclusion Cases*, 389 U.S. 486, 524 (1968). This Court has ruled that the reviewing function, in connection with valuation for purposes of Section 5(2)(d), is to make certain that agency actions "are based upon substantial evidence and to guard against the possibility of gross error or unfairness." *Id.* The proper scope of review of the Commission's valuation findings under Section 77(e) of the Bankruptcy Act is no broader—and perhaps narrower, in view of the express statutory mandate as to the Commission's role and the legislative history—than the scope of review under Section 5(2)(d).

The Three-Judge District Court recognized and applied the standards of judicial review established by the decisions of this Court and required by the provisions of the applicable statutes. It referred to the "limitations on the scope of our review" and observed that "we must be on guard lest the familiarity about the facts of the case we have somewhat painfully gained should lead us simply to substitute our views for those of the agency which Congress has appointed."* And it accurately observed at the

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* 305 F. Supp. at 1053-54, App. 404a, 406a.

conclusion of its opinion that it believed that its disagreements with the Reorganization Court "reflect a difference in view concerning how far we are at liberty to substitute our own notions for the decisions the Commission has taken in what we regard as a sincere effort to comply with the tasks both courts assigned it on remand."*

In contrast, the Reorganization Court disregarded the allocation of functions specifically made by Congress, disregarded the established standards of review, and substituted its own valuation findings for those of the Commission. The effect of these errors on the Reorganization Court's consideration of specific issues will be discussed in later sections of this brief.**

In their briefs before this Court most of the appellants simply ignore the established standards of judicial review and advance arguments which assume this Court will disregard those standards. Appellants fail to show either that there was no substantial evidence to support the Commission's valuation findings or that the Commission disregarded applicable statutory criteria. Instead, the arguments attack the Commission's appraisal of the weight and significance of the evidence, the inferences and conclusions that the Commission drew from the evidence, and the wisdom of the Commission's judgment as to the methods to be used in determining a realistic liquidation value.

Alone among the appellants the Committee faces up to the fact that arguments of this type will not serve to invalidate the Commission's order if the established standards of review are to be observed. The Committee (pp. 35-48) invites this Court to make a *de novo* appraisal of the evidence

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* 305 F. Supp. at 1065, App. 431a.

** An indication of the nature of the Reorganization Court's error is apparent on the face of its "Order Adjudging the Price to be Paid by Penn Central Company" dated July 28, 1969. In that order, the Reorganization Court stated ". . . . this Court now finds and concludes as a matter of law that . . .", and then proceeded to make a number of specific dollar findings as to value.

and to make its own valuation of the New Haven properties "uninhibited by the technicalities of the substantial evidence rule." (p. 46). It does so on the ground that "the Commission, because of its multiple functions, was incapable of the neutral and critically detached analysis of the evidence to which litigants are fairly entitled." (p. 48).

The Committee's argument is that (a) under the Interstate Commerce Act, and the declaration of national transportation policy that it contains, the Commission is obliged to give consideration to the public interest in adequate, efficient and economical transportation facilities and to the effect that inclusion terms may have upon the capacity of Penn Central to discharge its responsibilities as an important part of the national transportation system; (b) in the instant case the Commission did give weight to these considerations; and (c) as a result these considerations "so dominated" the Commission that it could not make "an impartial adjudication of the evidence." (p. 46).

The short answer to this contention is that Congress has prescribed a statutory plan that requires the Commission, in reorganization and merger proceedings, to consider the public interest as well as the private interests of the creditors or security holders who may be involved, and this Court has recognized that fact in the decisions that establish the standards for judicial review. In *Reconstruction Finance Corp.* v. *Denver, R.G.&W.R.R.*, 328 U.S. 495, 535-536 (1946), this Court referred to the duty of the Commission "to plan reorganizations with an eye to the public interest as well as the private welfare of creditors and stockholders." It noted that the holders of railroad securities "by their entry into a railroad enterprise, assumed the risk that in any depression or any reorganization the interests of the public would be considered as well as theirs." It follows in determining a realistic liquidation value of the New Haven, it was entirely proper for the Commission to give due consideration to the fact that any overvaluation might erode the merger savings and impose unjustified burdens upon Penn Central,

thereby impairing its capacity to provide efficient and economic transportation services.

Moreover, there is no support for the bondholders' assertion that the Commission was "dominated" by public interest considerations or that it was moved by those considerations to find anything less than a fair estimate of what the bondholders would receive under the circumstances of an actual liquidation. Indeed, a persuasive argument can be made that in a number of important instances the Commission overvalued the assets of the New Haven to the substantial benefit of the bondholders. See Part Two, Point VI, below.

In Part One of this brief we discuss the four issues which constitute the area of *disagreement* between the Reorganization Court, on the one hand, and the Three-Judge Court and the Commission, on the other. On these issues it is our position that the Commission and the Three-Judge Court were correct and the Reorganization Court was in error. In Part Two we consider the area of *agreement* between the Commission and the two Courts.

PART ONE

Issues Involving Disagreement Between The Two Reviewing Courts

I. In determining the liquidation value of the New Haven the Commission did not err by making an allowance for the delay and costs that would be involved in obtaining a certificate of abandonment.

A. *There is no merit in the argument that an allowance for abandonment delay is improper.*

In its Remand Report the Commission determined that, in appraising the liquidation value of the New Haven, an allowance should be made for the fact that, before the New Haven could actually begin the process of liquidation, it would have to obtain a certificate of abandonment from the Commission pursuant to the provisions of Section 1(18) of the Interstate Commerce Act. In the exercise of its judgment, the Commission further determined that to obtain the certificate would take at least a year and that this delay would adversely affect the liquidation value of the New Haven properties. It then made specific dollar findings to give content to this delay. We submit that these determinations are fully supported by the record and represent a reasonable exercise of judgment by the Commission which is not erroneous as a matter of law.

It is indisputable that in fact the New Haven could not have embarked upon any actual liquidation of its property without first obtaining an abandonment certificate. This was recognized by both the courts below and is not denied by appellants.* The Commission's finding that liquidation would be delayed pending an abandonment proceeding has, therefore, a solid basis both in the provisions of the Interstate Commerce Act and in the facts that

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* 289 F. Supp. at 444, App. 366a; 289 F. Supp. at 459, App. 245a.

would exist in the event of an actual liquidation. The Commission's action in making an allowance for such a delay is supported by the recognized principle of law that, in determining the value of property, due allowance must be made for the existence of governmental restrictions or for the costs and risks incidental to their removal.*

In making the allowance for abandonment delay, the Commission did not, as appellants and the Reorganization Court seem to suggest, assume that the New Haven would ultimately have been denied an abandonment certificate and thereby be required to continue deficit operations indefinitely. On the contrary, the Commission assumed that the certificate would be granted, but that at least a year would be consumed in contested proceedings under Section 1(18). In such proceedings public agencies and other interested persons would raise issues with respect to the necessity for abandonment, its timing, possible alternatives to the scrapping of the railroad (or sections thereof), and conditions that the Commission might properly attach to the certificate. Since the Commission assumed the ultimate issuance of the certificate and not the continuance of deficit operations, its determination does not raise the legal issues dealt with in the line of cases represented by *Brooks-Scanlon Co.* v. *Rail-Road Commission,* 251 U.S. 396 (1920).

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* While the instant case is not a condemnation proceeding, the condemnation cases furnish frequent examples of the valuation principle stated above. *E.g., United States* v. *Delano Park Homes,* 146 F.2d 473, 474 (2d Cir. 1944) (L. Hand, J.) (court said "condemnation will prove a bonanza" if deduction were not made to reflect governmental restriction); *Graves* v. *United States,* 62 F. Supp. 231, 233 (W.D.N.Y. 1945) (governmental restrictions "were actualities which circumscribed the market"); *Scott Lumber Co.* v. *United States,* 390 F.2d 388 (9th Cir. 1968) (valuation of forest land must consider restrictions of California Forest Preserve Act); *Terminal Coal Co.* v. *United States,* 172 F.2d 113 (3rd Cir. 1949). Cases involving zoning restrictions are analogous. See 9 ALR 3rd 291 (1966); 1 Orgel, *Valuation under Eminent Domain* §28 (2d ed. 1953); 4 Nichols, *Law of Eminent Domain* ¶12.322 (rev. 3d ed. 1962).

Indeed, the Commission did not even assume that during the period in which the abandonment certificate was being sought the New Haven would have been compelled to operate its trains. On the contrary, it assumed that because of lack of resources, the trains would stop but that liquidation would not begin until the abandonment certificate had been issued.* In short, the Commission simply made a reasonable allowance for the effects on liquidation value that it believed would be a necessary consequence of the period of time required to obtain an abandonment certificate.**

At points in their attacks on the Commission's allowance for abandonment delay, appellants suggest that as a matter of law there in some implied limitation in the concept of "liquidation value" that prevented the Commission from giving any consideration to the effects on value that might follow from the necessity of removing a valid government restriction on liquidation. They argue that the notion of liquidation value compelled the Commission to value the properties of the New Haven as if it possessed something which the law required but which it did not have, *i.e.*, an abandonment certificate. Appellants cite no authority for any such legal proposition and it can-

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* In this respect the Commission simply assumed the state of facts suggested by the Reorganization Court in its opinion of August 10, 1968, *i.e.*, "While liquidation will have to await authority to abandon, the trains will stop" because of the lack of necessary funds to pay operating expenses. 289 F. Supp. at 459, App. 245a.

** The Commission valued the New Haven properties as of December 31, 1966. If it is assumed that the New Haven would have made an application for an abandonment certificate at that time, the Commission's determination may be regarded as assuming that the actual liquidation would have been begun on January 1, 1968. On the other hand, it might reasonably be assumed that the New Haven would not have applied for an abandonment certificate until the fate of the Penn Central merger became certain. Had that merger not been consummated on February 1, 1968, the New Haven would then have been confronted with abandonment. The Three-Judge Court described this alternative hypothesis as "possibly more logical". 305 F. Supp. at 1058, App. 416a.

not be reconciled with the decisions cited in the footnote at page 27 above.*

In fact the appellants' attack on the abandonment allowance does not rely upon any principle of valuation law but instead rests upon the assertion that general considerations of fairness make the allowance so prejudicial to the bondholders that the Court should reject the Commission's judgment. This argument will not endure analysis.

Two notions permeate this argument. They are (1) that if it had not been for the prospect of the Penn Central merger the New Haven would have obtained a certificate of abandonment long before the valuation date of the New Haven properties and (2) that even if the New Haven had applied for a certificate while the Penn Central merger was pending the Commission would have denied it. These

* The same comment may be made on the Reorganization Court's suggestion that in determining the hypothetical liquidation value of the New Haven, the Commission "was limited to determining price through the historically recognized theory of fair liquidation value in a context where all elements of sale were present and only price remained to be fixed." 304 F. Supp. at 805, App. 292a. The Court cited no authority for this asserted rule of law.

Appellants attempt to support their argument by the citation of cases which they say indicate that heretofore the Commission in determining scrap value has never made allowance for the delays and the costs of abandonment proceedings. *Tennessee Central Ry. Co. Abandonment*, 331 I.C.C. 433, 454-55 (1968); *New York Central R.R. Co. Acquisition of Chicago, Attica & Southern R.R.*, 187 I.C.C. 527 (1932); *New York Central R.R. Co. Acquisition of Boyne City, G&A R.R.*, 180 I.C.C. 538, 564-65 (1932); *Jay Street Connecting R.R. Abandonment*, 307 I.C.C. 137, 163 (1959). See Mfrs., pp. 40, 49. Two of the cases (*Tennessee Central* and *Jay Street*) involved actual, not hypothetical, abandonments—and hence actual, not hypothetical, abandonment delays. The owners of the railroads involved actually experienced the time of a Section 1(18) proceeding, which the Commission here hypothesized. Obviously in those cases there was no room for a further discount based on a second Section 1(18) proceeding. In the other two cases (the New York Central acquisitions) the issue was never raised, the aggregate values found were $165,000 in one case and $230,000 in the other, and the cases do not have any force as precedents for how the Commission should determine liquidation value here.

assertions do not prove that it was unfair for the Commission to adopt an abandonment allowance. They are nothing more than arguments that because the New Haven deliberately chose to pursue inclusion and not liquidation, it should now be permitted to avoid the consequences of that choice and the Commission should be compelled to determine liquidation value on a basis that ignores restrictions which exist in both law and fact.

The New Haven voluntarily sought inclusion in Penn Central. If it had not done so the Commission would have had no authority under Section 5(2) of the Interstate Commerce Act to compel inclusion. *St. Joe Paper Co.* v. *Atlantic Coast Line R. R.*, 347 U. S. 298 (1954). The bondholders acquiesced in the New Haven's choice and their decision can reasonably be regarded as prompted by self-interest.* The bondholders can hardly contend that the New Haven's action was induced by Penn Central. Penn Central did not propose or embrace inclusion but accepted it reluctantly when it became apparent that inclusion might be a necessary condition to approval of the merger. Certainly the bondholders cannot fairly blame Penn Central for the delay in Commission approval of the merger or its consummation. That delay was a result of the necessarily protracted proceedings before the Commission on approval of the merger and by suits for judicial review instituted by other parties.

The New Haven never withdrew its petition for inclusion and it was not until the spring of 1967 that any of the bondholders made any move to terminate the New Haven operations.** In fact, even at that time some of the bond-

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* The Reorganization Court observed that at the time the petition for inclusion was filed inclusion "was thought to be the solution which best served the interests of the creditors as well as the public interest." 289 F. Supp. at 456, App. 242a.

** In April, 1967 the Committee made an application to the Reorganization Court for termination of the New Haven operations. The Reorganization Court denied that application on February 13, 1968. It was not until August, 1968 that the Reorganization Court determined that the condition of the New Haven would reach a point by December 31, 1968 at which an application for abandonment would be necessary absent early inclusion in Penn Central.

holder interests were arguing before the Commission that the New Haven could be viable as a freight-only railroad.* Given all these circumstances the bondholders complaint that the Commission would have denied any application for abandonment is both incongruous and irrelevant. Speculation as to what the Commission might have done if the New Haven had rejected the possibility of inclusion and sought liquidation is pointless. The New Haven and the bondholders did not ask for or want a certificate of abandonment. They voluntarily chose inclusion—and not because they were compelled to do so but because they thought it would best serve their interests.

When the bondholders decided that they would be better served by inclusion in Penn Central than by liquidation of the New Haven, they took upon themselves the disadvantages as well as the advantages of that course. One of the disadvantages was that waiting for inclusion would delay the date when the New Haven might apply for or the Commission might authorize abandonment. If the legality of the Commission's approval of the merger had not been sustained—a matter not resolved until January 1968—or if Penn Central decided not to go through with the merger—a doubt that was not removed until February 1, 1968—the New Haven could not thereafter have begun a liquidation until it had obtained a certificate of abandonment. Given these circumstances, it was not unfair or arbitrary for the Commission in 1968 to recognize that the New Haven could not begin liquidation until it had obtained a certificate of abandonment and to make due allowance for that fact in determining its liquidation value.

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* In the spring of 1967 Manufacturers and Chase presented testimony through Mr. William Wyer designed to demonstrate the viability of the New Haven as a freight-only railroad. In its brief to the Commission dated June 5, 1967 (p. 46) Manufacturers said that the Wyer study "showed that it was feasible to operate the New Haven profitably as a freight-only railroad and that such a railroad could generate sufficient income from the sale of surplus property and from its annual net income to make the necessary improvements." App. 231c; see App. 231-34c.

The bondholders' references to the operating losses incurred by the New Haven while the inclusion proceeding was pending do not assist them. They voluntarily invested in a public utility whose abandonment was subject to legal regulations of which they were aware. Furthermore, there is implicit in these references a notion that fairness is a unilateral concept and requires that only the interests of the bondholders be considered. Their argument ignores the fact that Penn Central is being required to assume the New Haven operating losses for the indefinite future, that Penn Central cannot realize upon the liquidation value for which it is being asked to pay, and that the bondholders, in attacking the allowance for abandonment delay, are simply arguing that the New Haven should be paid a higher price for its properties than it could have obtained if, in fact, it had pursued the alternative of liquidation.

The bondholders' appeal to fairness amounts to an assertion that because they chose, for reasons of self-interest, to defer an application for abandonment pending the Penn Central merger, fairness compelled the Commission to determine the liquidation value of the New Haven on the assumption that an application for abandonment was *not* deferred. There is no relationship between the premise of that argument and its conclusion. It was entirely fair and reasonable for the Commission to refuse to invert reality and for it to value the New Haven properties as subject to a liquidation restriction which existed both in fact and in law.

A final theme in appellants' arguments is that it was grossly unfair for the Commission, in determining liquidation value, to make any allowance for abandonment delay because, absent the Penn Central merger, any New Haven application for abandonment would have been a "formalistic exercise" that could have been summarily and promptly consummated.* This argument misconceives the obligation of the Commission under Sections 1(18) and

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* See *e.g.*, Committee, pp. 75-76.

1(19) of the Interstate Commerce Act and ignores record facts which demonstrate that any such abandonment proceeding would not have been an empty or cursory formality.

Section 1(19) of the Interstate Commerce Act provides that, whenever an application for abandonment is filed, the Commission must give notice thereof to, and file a copy of the application with, the governor of each state in which any portion of the lines of the railroad seeking abandonment are located. The Commission is also required to publish the notice for three consecutive weeks in a newspaper of general circulation in each county in which the lines to be abandoned are located. The section further provides that anyone objecting to the abandonment shall be given an opportunity to be heard.

The record here leaves no doubt that if the New Haven had filed an application for abandonment there would have been vigorous opposition from the States of New York, Connecticut, Rhode Island and Massachusetts, from public agencies in those States, from shippers, commuters and the public generally, and presumably from the United States Department of Transportation.* The Commission would have been obliged to accord a hearing to all of these interests and to give them a full opportunity to present any evidence or arguments in support of their positions.** And

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* See for example the testimony of Lt. Gov. (now Gov.) Francis W. Sargent of Massachusetts (T. 22851-55), and of Frank M. Reinhold, Chairman of the Connecticut Transportation Authority (NHI-25). See R. 6-11, statements of shippers. The Department of Transportation filed a statement in the proceeding emphasizing the public importance of the operation of the New Haven (R. 44).

** There is a suggestion in the opinion of the Reorganization Court, which is echoed in certain arguments of the appellants, that little consideration need be given to the possibility of state opposition because no state has heretofore come forward with any definitive solution of the New Haven problem. But this fact would not relieve the Commission of its obligation under Section 1(19) to give the states and all other persons a full and fair hearing. (cont'd)

there is no doubt that the evidence and arguments would not have been limited to the general issue of whether a certificate of abandonment should issue; it would also have encompassed such related matters as the timing of any abandonment, the extent to which transportation facilities should be dismantled, whether the operation at least in part could be continued under public auspices and with public subsidies,* and whether conditions relating to any of these matters should be attached to an abandonment certificate.**

Even if it is assumed, as the Commission did assume in making its abandonment delay allowance, that a certificate would ultimately have been issued, the Commission would nevertheless have been required to receive all of this evidence and these arguments, to give them full and impartial consideration and to give a full and reasoned ex-

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In this connection the observation of the Three-Judge Court is pertinent to the likelihood of state action when faced with the reality of a cessation of train operations:

> "And legislatures can hardly be expected to volunteer to assume large financial burdens so long as they have a reasonable expectation that part of these will be shouldered by a private corporation." 305 F. Supp. at 1057, App. 412a.

* It is entirely possible that the states or federal government might have sought to acquire a temporary leasehold interest or operating rights so as to operate the trains on an interim basis under public auspices. There is ample authority and precedent for such arrangements. *E.g., Kimball Laundry Co.* v. *United States*, 388 U.S. 1 (1949); *United States* v. *Pewee Coal Co.*, 341 U.S. 114 (1951); *Anderson* v. *Chesapeake Ferry Co.*, 186 Va. 481, 43 S.E.2d 10 (1947).

** The Reorganization Court criticized the Commission because it had not applied the concept of abandonment delay in the Inclusion Report. 304 F. Supp. at 805, App. 292a. The criticism overlooks the fact that on remand the Commission was free to reconsider methods of determining liquidation value. See *FCC* v. *Pottsville Broadcasting Co.*, 309 U.S. 134, 145 (1940). The Commission explained why it had not considered abandonment delay in its Inclusion Report (334 ICC at 54, App. 141a) and the explanation was accepted by the Three-Judge Court. 305 F. Supp. at 1052, App. 402a.

planation of its decision on their merits. And any determination that it made would have been subject to judicial review. There is, therefore, no warrant for the assumption that, absent the Penn Central merger, the Commission could or would have summarily issued a certificate of abandonment.

To summarize, the Commission's allowance for an abandonment delay was entirely fair and reasonable. The allowance followed as a matter of course from the decision to apply to existing facts the valuation standard of a hypothetical liquidation which, indeed, was the only possible standard attributing any substantial worth to the properties of the deficit-ridden New Haven. Having adopted that standard, there was no reason to favor the bondholders by assuming facts which did not exist and ignoring delays and vicissitudes that would be an integral part of an actual liquidation. The bondholders' arguments do not establish that such a departure from reality would itself be fair or reasonable, let alone that the Commission's choice in subscribing to reality was an abuse of discretion and amounts to error of law.

B. *The Commission's determination that an abandonment application would involve a year's delay is reasonable and should be accepted.*

The Commission is a uniquely qualified finder of fact in respect of the question of abandonment delay. It has a wealth of experience with innumerable abandonment proceedings, either total or partial, since Section 1(18) was enacted. Clearly, under established principles of administrative law, the Commission was entitled to rely on its own expertise in estimating the time required to conduct these proceedings.* In the light of what has been said at pages 32 to 34 above concerning the foreseeable complexity of

* See *Board of Trade* v. *United States*, 314 U.S. 534, 547 (1942).

any proceeding for abandonment of the New Haven, the Commission's estimate was on the conservative side.

During the preparation of the Remand Report the Commission had before it an earlier version of the table annexed to this brief as Appendix C. As Appendix C indicates, the average elapsed time between an application for abandonment and the obtaining or denial thereof has, in the eight years 1960-68, in cases in which appeals have been taken from the Commission orders, exceeded three years. In not one of those cases was a railroad of the size and significance of the New Haven involved.*

The Commission's use of the extraordinarily optimistic "minimum" one-year period obviously gave no recognition to the almost certain appeals to the courts from any order of the Commission granting an abandonment certificate.

The bondholder suggestion** that all the abandonment issues were considered in the New Haven's passenger discontinuance case in 1965 and early 1966 is a sheer misconception of the scope of that proceeding, which was under §13a of the Interstate Commerce Act. In that proceeding the Commission was not called upon to decide the question of cessation of the freight service, and the evidence was not directed to the necessity for the freight operations.

Clearly, there was a substantial basis for the Commission's finding of a one-year minimum period for abandonment proceedings.

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* The Commission's citation of the Rutland Railway abandonment at 334 I.C.C. at 59, App. 146a, could have been made even stronger by noting that the trains had stopped running more than two months before the application was filed. Even earlier, that service had been reduced to the vanishing point. In terms of public interest, the case was not even remotely comparable to the New Haven situation.

** Committee, pp. 75-76.

C. *The Commission's quantification of the economic effect of a one-year delay in commencing liquidation was based on substantial evidence.*

The finding of a minimum of one-year before commencing liquidation required determining the dollar impact of such a pre-liquidation period. The Commission's findings were as follows:

Added discount for time, at 6%:	$ 7,946,000
Preservation costs:	4,940,000
Additional real estate taxes:	2,500,000
Total	$15,386,000

These estimates were all based on substantial evidence and were reasonable and rational. They greatly understate the actual adverse impact on the economic position of the bondholders which the required abandonment proceedings would produce.

(1) *Added discount for time.*

The Commission's discount of 6% for one year for abandonment delay is a discount for time only, and did not require testimony in addition to that already in the record as to discounting of liquidation proceeds and expenses.*

The bondholders state that substantial progress could be made toward the sale of the New Haven assets during the year preceding the commencement of liquidation.** As a result, they argue, only items to be sold in the first year

* The 6% rate is obviously an understatement, since it was a prime bank rate reflecting no risk. The bank prime rate was 6% at December 31, 1966. App. 182c. We note that Manufacturers, in another context, points out that a rate higher than 6%, such as 8%, "may seem more appropriate in the present money market", for the discounting of a corporate obligation to pay money. Mfrs., p. 66n.

** Mfrs., pp. 42-43; Committee, pp. 77-78.

should be discounted for delay, and sales scheduled for later years would not be delayed.

The evidence is to the contrary; the very factors which mandated the minimum six-year marketing program would strongly militate against the feasibility of compressing two years of selling into one. The marketing program was spread over a period of years largely in recognition of the problem of market absorption. The advance negotiating visualized by the bondholders during the pre-liquidation year could not possibly relieve the subsequent year (the first year of liquidation) from the adverse impact of pushing into a single year the actual sales projected for two years.* In addition, the marketing schedule was programmed in recognition of the fact that "the Railroad's track removal program would require some three years to accomplish." (App. 111c.). Obviously, this physical fact could not be accelerated, and it renders completely improbable the bondholders thesis that two years of actual sales could be compressed into the first year of liquidation.

Similarly, it is improbable that the acute limitations on trained staff referred to by Mason (App. 111-12c) would permit throwing into one year the immense mechanics of the closing transactions for two years of sales (the "*consummation*" he referred to), even though there had been advance *negotiation.* Furthermore, until the end of the abandonment proceeding it could not be known what conditions the Commission might attach to the disposition of particular property (as, for example, by requiring that certain of the properties first be offered at a fair price to persons willing to continue rail service). This circumstance, together with the fact that the date of abandonment would be completely uncertain, would make serious negotia-

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* As Mason, Vice President of Meredith & Grew, a New England real estate firm, who prepared the minimum six-year program, testified:

> "[A]n accelerated sales program, even if physically possible, might only be accomplished in practice by sacrificing in part the total consideration that might otherwise be achieved." App. 112c.

tions or firm or even contingent commitments for the disposition of property well nigh impossible.

In summary, the Commission had a substantial basis for assuming that the consequences of a one-year delay in obtaining an abandonment certificate would be to delay the entire liquidation by one year.*

A second challenge to the Commission's computation of the dollar impact of a one-year delay is the argument of the bondholders that a substantial amount of New Haven non-operating property could actually be sold during the year *prior* to the receipt of the abandonment certificate. This again is completely contrary to the evidence, which supported the proposition suggested by the Three-Judge Court, namely, that "with their serious cash stringency, the NH trustees had done about all such selling that they could."** The bondholders produced no evidence as to non-operating property available for sale.

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* In the situation of the New York, Ontario & Western Ry. cited by the bondholders, progress toward liquidation was made prior to obtaining an abandonment certificate only because there was no dispute as to the likelihood of the property again being devoted to railroad operations. Even in that case the receipt of bids did not begin until over ten months following the Commission's decision recommending dismissal of the reorganization proceedings and about five months after the reorganization court dismissed such proceedings. I.C.C. Finance Docket No. 19861, at sheet 4.

** 305 F. Supp. at 1058; App. 415a. Trustee Smith testified that, from the outset of the trusteeship, the Trustees "were faced with an immediate cash problem in the operations of the New Haven" which "has continued to be one of the more pressing factors in the administration of this estate." (NHI-1, pp. 2-3.) At the remand hearings, he stated that this cash problem had been met in part by "disposal of items of property which are not required for operations", adding that net proceeds of $27.5 million had been derived from the disposal of all types of property, primarily from real estate. (R-1, p. 5.) The tenor of the testimony of the New Haven's General Real Estate Agent was that additional abandonments of line would be necessary to make substantial parcels available. (T. 23537-39; 23548-49.)

(2) *Preservation costs.*

The term "preservation costs" has been used to cover a combination of unavoidable overhead and costs incurred in "mothballing" the physical equipment of the New Haven if trains had stopped running but no authorization to dismantle and sell had been received. These costs were taken from the uncontradicted testimony of Trustee Smith.*

Manufacturers (p. 44) incorrectly reports the state of the record when it says the "sole evidence of record is two sheets of paper (Ex. R-43, Rec. 374-75c), describing the expenses associated with temporary cessation of operations, which was put in evidence through New Haven Trustee Smith", and when it implies (p. 45) that the Exhibit was admitted for a limited purpose. The facts are precisely the opposite, in that (a) Smith not only gave the $4.9 million figure of first-year costs in his direct testimony (R-1, p. 7), but also the breakdown of the $4.9 million (T. 28661-63); and (b) the Hearing Examiner's rulings as to the admission of R-43 (the two "backup" or "work sheets"** which Manufacturers is referring to) were unlimited.***

The figure of $4.9 million was competent evidence when set forth in Smith's prepared statement (R-1, p. 7), and no subsequent quarrel as to the scope of the Hearing Examiner's admission of R-43 could affect the competency of such direct testimony.

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* R-1, pp. 6-8; T. 28661-66.

** These are the terms used by counsel for the Trustees. (T. 28664, 28666.)

*** T. 28666, 28798. A fair reading of the remarks of counsel for the Trustees shows that he had no intention of limiting the purpose for which the work sheets could be used, although his comments in support of his unqualified offering of the work sheets *included* the observation that the work sheets were relevant to the Trustee's position as to the costs of preservation. (T. 28664-65; T. 28796-97.) The Hearing Examiner ignored the comments of Manufacturers' counsel made in withdrawing his own objection and Manufacturers' counsel asked for no ruling as to limitations on the use of the exhibit R-43. (T. 28798.)

We submit that Manufacturers also conveys an erroneous impression of the record as to the nature of the $4.9 million figure. Manufacturers (p. 45) says that "Exhibit R-43 was identified, on its face, as relating to the preservation costs of a temporary cessation of operations, *with the intention of resuming operations later on.*" (Emphasis added.) However, the italicized words in the foregoing description appear nowhere on the Exhibit and nowhere in the testimony.* Smith had been explicit in his prepared statement that the preservation costs of $4.9 million (for the first year) would be incurred: "*Even if the bulk of the property ends up being sold as scrap . . .*" (R-1, p. 6; emphasis added.) Thus, the Exhibit was prepared with the dismantling hypothesis in mind as well as the possibility of "sales in place" of segments of road property (*i.e.*, without track removal)** and the third possibility of some form of resumption of operations. The word "temporary" in the heading of R-43 simply indicated that a mothballed status quo would not continue indefinitely; absent resumption of operations or sales in place, the property would be dismantled and sold as scrap, as Trustee Smith indicated.***

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* The heading of R-43 was "Summary—Estimated Costs of Temporary Cessation of Operations with No Liquidation of Properties." From Smith's testimony as to the purpose of the Exhibit, it is clear the heading's words "no liquidation" meant "no liquidation at this time."

** See NHI-101, p. 77, for testimony on behalf of the bondholders contending for this possibility.

*** The statements of Auerbach, counsel for the Trustees, at the pre-hearing conference immediately preceding the remand hearings (September 10, 1968) indicate clearly that the preservation cost study, which was then in preparation and had been publicly referred to as a "burial fund", was calculated "in terms of how much money is required to preserve the estate from the day it ceases operation, whatever day that may be, until the day that the assets of the estate can properly be disposed of". It should be noted that even under the dismantling hypothesis much of the rolling stock would be sold for *reuse* rather than for scrap (NHI-42, pp. 24-26), and hence preservation of its value would depend on incurring the preservation costs.

Manufacturers also criticizes various particulars of the figures which Smith presented. However, the bondholders had full opportunity to cross-examine Smith. (T. 28667-83, 28689). Counsel for the Trustees also offered for cross-examination additional personnel of the New Haven who assisted in the preparation of the figures. (T. 28797.) The comment in Manufacturers' brief that "no such cross-examination was requested" (p. 46) is indeed specious, since it is now Manufacturers which seeks to question the bases of the figures. Even the specific criticisms now offered to the figures are patently ill-founded.*

(3) *Real estate taxes.*

The figure of $2.5 million adopted by the Commission for additional real estate taxes was presented in testimony of Trustee Kirk. (T. 28814.) There was no contrary testimony.

Again, the bondholders develop an alternative computation—they assume that only the real estate sales scheduled for the first year of a six-year liquidation would be deferred and argue that the additional taxes would apply only to real property scheduled to be sold in the first year.** However, as demonstrated above, the bondholders' premise of an accelerated sales schedule is without any evidentiary foundation.

The further argument of Manufacturers that the New Haven's share of Grand Central Terminal excess income for one year must be subtracted from the additional costs*** has no merit. Such income has been declared to be in the

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* For example, Manufacturers questions the estimate of legal expenses. However, it is reasonable to believe that these legal expenses, encompassing the contest over abandonment before the ICC and probably in four states, would at least equal the legal expenses of a first year of actual liquidation. The latter were estimated at $1,000,000 in the liquidation study. (NHI-42, p. 37.)

** Mfrs., p. 47; Committee, p. 83.

*** Mfrs., pp. 46-47; Committee, p. 82.

nature of a debt wholly apart from liquidation or inclusion, and thus outside the scope of the liquidation analysis. The New Haven Estate has already been paid the New Haven's share of the G.C.T. excess income for the years 1967 and 1968.* To be credited with such income again would be a double payment for the same item.

The bondholders also claim that $1,000,000 of rental income would be earned during the pre-liquidation period. However, the New Haven witnesses testified that the rental income would drop sharply with cessation of rail service and continue to decline each year—down to $1,000,000 in the first year after cessation of train service and to zero at the end of a six-year period.** Since the pre-liquidation period assumes immediate cessation of train operations, the rental income would begin to decline immediately in accordance with the same schedule. The Commission had already taken 100% of this wasting asset of rental income into account as part of Mason's estimate of net liquidation expenses.*** If the Commission had advanced the rental income schedule by one year, there would have been no increase in liquidation value, for the entire wasting asset could properly be credited only once.

* * *

From the foregoing, it is clear that the Three-Judge Court was correct in concluding that the Commission's calculations were reasonable and supported by substantial evidence. The Three-Judge Court also correctly noted that several factors in the Commission's calculations favored the New Haven bondholders, including (1) "the Commission's failure to deduct a further year's depreciation of some $3 million"; and (2) "the conservativeness of the estimate that one year would suffice for an abandonment proceeding of such magnitude and possible judicial stays."†

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* App. 307-11a; App. 449a.

** App. 115c; T. 23685.

*** App. 117c.

† 305 F. Supp. at 1058, App. 415a.

II. The Commission's finding that a determination of the realistic liquidation valuation of the New Haven land required an increased discount to reflect the risks involved in a six-year marketing program is supported by substantial evidence and is correct as a matter of law.

The liquidation study prepared for the New Haven Trustees and adopted in the Inclusion Report had valued the New Haven land essentially by adding up the predicted selling prices of over 3,000 separately appraised parcels, deducting marketing expenses and discounting the future proceeds to present worth on the valuation date at a rate of 6%. Testimony of Robert E. Simon, Jr., an expert and consultant in large-scale land transactions, presented on remand, demonstrated that this method overstated the fair market value, and hence the realistic liquidation value, of the land on the valuation date. The testimony concluded that an increased discount was required in recognition of the risks that projected time schedules would not be met and appraised sales prices would not be realized in the course of the six-year marketing program of 3,000 parcels of New Haven land.*

Utilizing data from the expert testimony (App. 485c, 487-88c) and adopting a well-recognized "band of investment" method of valuation, the Commission arrived at an overall discount rate of 10.5% for the predicted future net real estate proceeds, in order to establish market value as of the valuation date.

The Three-Judge Court approved the Commission's result as rational and based on substantial evidence.** The Three-Judge Court drew a correct analogy to the discount involved in the underwriting of securities.***

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* App. 364-50c.

** 305 F. Supp. at 1058-59, App. 417-18a.

*** In the case of an underwriting of securities, the value of the securities to the issuer (*i.e.*, what it receives) is the offering price to the public less the underwriting premium paid to the underwriting syndicate. The underwriting premium, aside from out-of-pocket expenses, is the measure of the risk assumed by the under-

A. *The discount has a rational basis in findings that are supported by substantial evidence.*

1. *The evidence justified the Commission's decision that an increased discount should be made for the risks and uncertainties that would be involved in a six-year marketing program.*

The Commission spoke of its increase in the discount of land proceeds from 6% to 10.5% as the "bulk sale discount." This was simply a convenient term to describe the method the Commission used to give a minimum dollar content to the risks that, in the hypothetical six-year marketing program, the New Haven would not (a) realize the total of the sales prices predicted in the appraisals of more than 3,000 separately appraised parcels, or (b) meet the projected time schedule of sales.

The New Haven's real estate constituted a massive total holding of 25,343 acres, under common ownership, located in four states.* However, the real estate appraisals made for purposes of the New Haven Trustees' liquidation study were made by hypothesizing sales of "normal size parcels",** resulting in the appraisal of over 3,000 individual parcels.*** They were all appraised as of the same date,

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writer that the securities will not all be sold at the offering price. Similarly, in the instant case, the discount as applied to the valuation of the mass of real estate held by the New Haven simply measures the risk that the sale of the property over a six-year period will not adhere to the predicted marketing schedule or will not produce the total of the separate appraisals. Indeed, in the case of real estate as compared with other commodities, the risks are increased because of the complete immobility of the commodity.

Simon had made it clear that his testimony would have been "totally different" if there were "an underwriting by a financially viable underwriter" which guaranteed the owner the receipt of the predicted net proceeds of the individually appraised parcels on the projected time schedule. App. 464-67c.

* NHI-45, p. 29.

** NHI-44, p. 6; T. 23441-42.

*** The New Haven real estate staff had appraised 3,012 parcels. T. 23756. In addition, the Bronx freight yards were appraised in 11 parcels. App. 63c.

December 31, 1965, and the appraisals hypothesized sales made at that time.*

The appraisers of the over 3,000 individual parcels proceeded under the standard definition of market value as applied to each of the individual parcels and assumed normal conditions.** They used customary appraisal methods for each parcel, without regard to problems of market absorption caused by the marketing of other parcels. The individual parcel-by-parcel appraisals in no way considered the risks of time and price inherent in an extended marketing program.

The hypothetical plan for the marketing of the parcels was developed by a witness for the New Haven Trustees, Mason, after the appraisals of the over 3,000 parcels had been completed.*** That witness believed that the marketing program would require an absolute minimum of six years.† Most of the witnesses thought the marketing program would require ten years or more.‡

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* NHI-45, p. 2 (heading).

** The definition in Mason's direct testimony was:
"The highest price estimated in terms of money which a property will bring if exposed for sale in the open market, allowing a reasonable time to find a purchaser who buys with knowledge of all the uses to which it is adapted and for which it is capable of being used." App. 108c.

*** NHI-58, p. 8. Mason's marketing plan contemplated some 1,700 sales, since it proposed to consolidate 1,625 appraisal parcels into 300 "salable parcels" for purposes of the last two years of the marketing program. Thus, the figure 1,700, which appears in the opinion of the Three-Judge Court, 305 F. Supp. at 1058, App. 416a, refers to *sale* parcels rather than appraised parcels.

† Mason stated that his six-year estimate "is on the low end of what we would consider to be a reasonable range of years to expect such a major underwriting to require" and added that "such a period may well be optimistic."-App. 111-12c; see also NHI-41, p. 13.

‡ Thompson, for the New Haven Trustees, T. 23706; Gasparini, for Penn Central, NHI-91, p. 10; White, for Penn Central, NHI-94, p. 7. The Commission recognized that the New Haven's own evi-

At no point in the appraisal and valuation process, as performed prior to the remand hearings, did a real estate expert testify as to how to evaluate all the risks involved in a marketing program extending over six years. The coordinator of the appraisals of the New Haven estate (William A. Gordon, of the consulting firm of Coverdale & Colpitts), under cross-examination, merely applied a discount rate of 6% to determine the present worth of proceeds to be received in future years, whether from land or tangible or intangible personal property. (T. 23418-20.) Mason conceded under cross-examination that he had not made an analysis of the proper discount rate to be applied to the net proceeds to be received in the future.*

At the remand hearings, Simon addressed himself to the question of the relationship of two figures: (1) the fair market value of the New Haven land in the hands of its owners on the valuation date, and (2) the valuation arrived at in the New Haven Trustees' liquidation study, *i.e.*, the predicted net proceeds of over 3,000 separately appraised parcels of the New Haven land, if sold over a six-year period, after applying a 6% discount rate to such future proceeds.** Simon testified that the first figure was sub-

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dence indicated that the six-year estimate was "optimistic" and "low" (App. 20a, 21a). Even so, the Commission concluded that "the *bulk* of the liquidation could be completed within a period of 6 years," (331 I.C.C. at 633, App. 21a; emphasis added), but used the six-year figure in its calculations as if the *entire* liquidation could be completed within that period. 331 I.C.C. at 661, App. 19a.

* T. 23798. He also conceded that: (a) there would be two components in determining the present worth of the future proceeds, namely, time and "the certainty of that dollar amount being actually realized"; and (b) in his "offhand opinion", without having made an analysis, Gordon's 6% rate was "on the low side". (T. 23798.)

** The bondholders suggest that Simon's testimony was deficient since he had not personally read "the valuation study evidence." Mfrs., p. 53; Committee, p. 90. This criticism is unjustified, since Simon's testimony proceeded on the basis of clearly enumerated assumptions which reflected and summarized "the valuation study evidence." App. 347-48c. He assumed that the parcel-by-parcel

stantially below the second. (App. 347c.) In substance, Simon's testimony (a) demonstrated that a valuation of the mass of the New Haven properties as of a specific valuation date and in advance of a six-year marketing program should make a proper allowance for the uncertainties and risks involved in the extended process of parcel-by-parcel disposition, and (b) presented a standard method for making such an allowance which rests on well-established principles of real estate economics.*

Simon's method of quantifying the risks was to determine the minimum rates of return necessary to attract capital to the business of owning and disposing of the New Haven's land. This is the quantification in the market place of the risks involved in selling the New Haven real estate over an extended marketing period. His expert opinion was that the lowest possible cost of capital one could project was derived by postulating a mortgage for 75% of the investment, at a minimum 9% interest rate, and "equity" money for the remaining 25% of the investment, at a minimum 15% rate of return. His testimony

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appraisals were reliable and that the marketing timetable was "realistic". App. 348c. The bondholders fail to point out any respect wherein Simon's summary of the record overlooked any aspect of "the valuation study evidence" material to his testimony.

* App. 349-50c. The mathematical expression of Simon's testimony is simply:

$\frac{X}{}$	=	$\frac{A}{}$	—	$\frac{B}{}$
Fair market value of land on the valuation date	equals	Predicted net proceeds from 3,000 separate parcels	minus	Market estimate of risks of engaging in marketing program after valuation date (including time discount)

In the foregoing formula, "X" is the unknown. "A" is known, and "B" can be determined by the process Simon described, as summarized below in text. This method of "working backwards" from the sum of predicted prices for smaller parcels is a standard technique of arriving at the fair market value of a large tract on the valuation date, as is explained below in text.

as to these minimum terms, which was not disputed, is discussed more fully below.

The Commission accepted Simon's valuation principles. The Commission converted his figure for minimum rates of return into a "weighted average" or a composite figure of 10.5%,* and adopted this as the overall minimum rate of return required for engaging in the business of the land ownership and marketing.**

Accordingly, the Commission increased to 10.5% the discount rate applicable to the predicted net proceeds from the sale of the individual parcels of New Haven real estate, with the result that the dollar amount of the discount of the net proceeds was increased by $6,695,000. The Commission expressly found that the result gave the bondholders "the full economic equivalent of the liquidation value of the assets" and described the additional discount as a reflection of "a market appraisal of the risks" that would be involved in engaging in the six-year marketing program.***

While Simon's testimony was cast in terms of the method of valuation that would be used by a person proposing to buy the mass of properties, the method would be equally applicable to the valuation of the property for any purpose calling for a determination of fair market value—whether the appraisal is made for a prospective purchaser, for the owner, or by a public agency charged with the obligation to determine value.

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* The method of determining the weighted average is:

Debt:	75% of capital	x 9% return	= 6.75%
Equity:	25% of capital	x 15% return	= 3.75%
		Weighted average:	10.50%

** 334 I.C.C. at 62, App. 149a.

*** 334 I.C.C. at 61, App. 148a. The Commission referred to the risks being shifted to the "bulk buyer". As explained below, neither the Commission's reasoning, nor the Simon testimony on which it is based, rests upon an assumption of the actual existence of a bulk buyer.

2. *The evidence showed that there would be substantial risks in a hypothetical six-year marketing program which were not covered by either the appraisals or the previous discounts.*

The appraisal of an individual parcel of land of "normal size" does not take into account risks arising as a result of an extended marketing period, since the only time required is that for adequate exposure of an individual parcel to the market.* However, in the case of the New Haven's massive land holdings, an extended marketing period would be required by reason of many factors, the principal one being that of market absorption.** Other factors would include the fact that the track removal program to ready the land for sale would require some three years to accomplish, and there would be limitations of trained manpower engaged in the selling effort.*** Under these circumstances, according to even the New Haven Trustees' marketing witness:

> "[Our] estimate of a six-year disposal period is on the low end of what we would consider to be a reasonable range of years to expect such a major undertaking to require."†

The introduction of a projected marketing period results in the emergence of two broad categories of risk: the first is that events will occur during the marketing period so that the predicted proceeds of the sale of a particular parcel, even though appraised conservatively as an

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* American Institute of Real Estate Appraisers, *Appraisal Terminology and Handbook*, p. 131 (5th ed. 1967).

** App. 111-12c. All the witnesses agreed that the relative concentration of the New Haven real estate in a limited number of market areas would make immediate disposition of the entire holdings at the forecast prices impossible.

*** App. 111c.

† App. 111c. The witness observed that the 10-year estimate of the New Haven's own real estate staff was "not in our view unreasonable." App. 111-12c.

individual parcel as of the valuation date, will not in fact be realized. Simon testified that "there are always risks of unforeseen developments which frustrate marketing plans or depress values." (App. 350c.)

In the case of the New Haven liquidation, a major risk would be the adverse impact that a cessation of New Haven service would have on land values. The testimony in this proceeding was clear, emphatic and wholly uncontradicted; liquidation of the New Haven would have serious adverse economic consequences to Southern New England and would substantially depress land values.* The Trustees' appraisers made it clear at the outset that their appraisals "assumed normal market conditions," and they were explicit that their values had been *"overstated"* to the extent that such an adverse effect would be reflected in the real estate market.** The Commission clearly recognized these facts in its Inclusion Report, but did not attempt to quantify them in dollars.***

The Three-Judge Court noted this facet of the price risk:

> "The idea of the states of Connecticut and Rhode Island and of a large part of Massachusetts being without rail service is so unthinkable that its consequences on land values are beyond possibility of accurate calculation."†
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> * * *
>
> "In addition to the factors emphasized by Mr. Simon, there is the fact, to which we have referred above,

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* App. 189-91c, 196-201c. Trustee Kirk indicated that cessation of rail service would have a spill-over effect since shippers would move elsewhere to obtain rail service. App. 229-30c.

** App. 61c (emphasis added).

*** The Commission specifically noted with reference to the New Haven Trustees' appraisals, "No weight was given to the possible impact of termination of NH operations on the real estate market generally." 331 I.C.C. at 667, App. 25a.

† 305 F. Supp. at 1053, App. 404-5a.

> that the appraisals gave no effect to the serious adverse economic consequences from discontinuance of NH's operations, 331 I.C.C. at 667.'"*

Another important risk involved in an extended marketing program is the risk of a decline in real estate activity generally, caused by higher interest rates and the resulting inability to proceed with construction projects.** This has occurred dramatically since Simon's testimony and even more dramatically since the valuation date.***

Of the risks enumerated by Simon, the one he most emphasized was that of not being able to maintain the marketing time schedule projected in the New Haven liquidation study. He said:

> "The uncertainty as to the precise time period for marketing the real estate is a tremendously important factor. In the financing, holding and disposition of real estate, time is unquestionably the most critical factor. Delays in realization of cash proceeds, as compared with the owner's projected schedule of receipts, can cause serious economic loss. The very best projections can and often do go awry. . . ."†

He pointed out that carrying charges, such as real estate taxes, and the costs of tying up capital in the investment

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* 305 F. Supp. at 1059, App. 418a.

** The New Haven's General Real Estate Agent had previously acknowledged that changes in interest rates could affect both the price of the New Haven land and the length of the marketing period. T. 23648-49.

*** Hollensteiner, *The Money Market*, Savings and Loan News, Vol. XC, No. 1, p. 9 (January, 1969); *Mortgage Market Trends*, The Mortgage Banker, Vol. 29, No. 10, pp. 25-28 (July, 1969); Wetmore, John M., *MBA's Mortgage Economic Outlook for 1969: Inflation 'Bug' Hits Home Financing*, The Mortgage Banker, Vol. 29, No. 4, pp. 12-14 (January, 1969); *Mortgage, Construction and Real Estate Markets*, Federal Reserve Bulletin, pp. 565-78 (July, 1969); National Association of Real Estate Boards, *The Mortgage Market* (Fall 1969).

† App. 349-50c.

(whether or not borrowed) would be very burdensome as a result of the delay. Of course, the risk of falling behind schedule applies to the projected sales of each year and each month of the marketing period, and does not refer solely to the question of completing all sales within the six-year period.*

The risk of falling behind the predicted marketing timetable would exist even if the Commission had made a finding that the liquidation could be completed in six years. The risk would be particularly great in this case, since even the Commission's own summary of the evidence shows great doubt that the liquidation could be completed in six years.**

3. *The evidence supported the Commission's composite discount rate.*

Simon's hypothesis of a 75% mortgage loan and 25% equity investment, and the Commission's derivation of a weighted average rate of return, represent a common and accepted approach to arriving at fair market value through a capitalization rate (or its converse, a discount rate) for real estate.*** It is known as the "band of investment" approach. It has been described in these terms:

> "The interest rate developed by application of the band of investment theory is a synthesis of mortgage and equity rates which market data disclose as applicable to comparable properties. The rate developed is a weighted average, the weighting being for percentages of the value which would be occupied by

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* Under cross-examination, Simon repeatedly underscored the importance of the element of *time* in the cost computations and hence the substantial risk factor involved. App. 461c, 465c. See *Encyclopedia of Real Estate Appraising*, p. 717 (E. Friedman ed. 1968).

** 331 I.C.C. at 663, App. 21a.

*** The rationale of capitalizing proceeds in the real estate field is articulated in American Institute of Real Estate Appraisers, *The Appraisal of Real Estate*, pp. 262-63 (5th ed. 1967).

the mortgage and equity positions, or band of investment.'"*

The validity of the "band of investment" analysis, as a sound appraisal method, is attested to by countless other treatises and articles in the field.**

The real estate authorities emphasize that hypothesizing a mortgage as part of the investment capital in the band of investment approach is merely part of the economic analysis and it makes no difference whether the owner or purchaser in fact would seek mortgage financing or any financing.***

The Commission was clearly justified in accepting Simon's figures for mortgage interest rates, equity return and debt-equity ratio; these figures were in no way disputed or contravened by any other witness.

Simon's direct testimony that the minimum mortgage interest was 9% was unequivocal and specific.† As to the equity portion of the hypothetical investment, Simon testified that "a 15 per cent profit is a very minimal profit in this kind of an enterprise, very minimal."‡ The rate of return necessary on equity in a land investment is widely regarded as approximately twice the first mortgage rate.‡‡

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* American Institute of Real Estate Appraisers, *The Appraisal of Real Estate*, p. 269 (5th ed. 1967). See Kinnard, *Industrial Real Estate*, p. 426 (1967).

** *E.g.*, Ring, *The Valuation of Real Estate*, p. 225 (1963); Kahn, Case and Schimmel, *Real Estate Appraisal and Investment*, p. 125 (1963); Kinnard, *The Financial Logic of Investment Property Appraising*, The Real Estate Appraiser, pp. 13, 18 (May-June 1969); Nelson, *Overall Rate—Band of Investment Style*, The Appraisal Journal, p. 25 (Jan. 1969); Sadesky, *Relationship of the Cost of Borrowed Money to Capitalization Rates*, The Appraisal Journal, pp. 9, 10 (Jan. 1968).

*** Sadesky, preceding footnote, at p. 12.

† App. 349c. Under cross-examination, Simon added that "these rates can run up as high as 20 per cent and more." App. 476c.

‡ App. 473-74c. See also App. 488c.

‡‡ Stunard, *Capitalization Approach and Financing*, The Real Estate Appraiser, pp. 31, 35 (May, 1967). See also Kinnard, *The*

Simon used a lower equity rate than this rule of thumb would indicate to be appropriate.

As indicated above, Simon testified that the most favorable capital structure one could hypothesize to finance the ownership of the land ("favorable" in the sense of keeping the financing cost or capitalization rate as low as possible) was a loan of 75% for the investment, with the remaining 25% of the investment represented by equity capital.* It should be noted that any failure to obtain a 75% loan would have the effect of raising the overall capitalization rate.**

The 6% discount rate which Gordon (who expressly disclaimed having any part in the appraisal of the real estate***) applied to future proceeds of the liquidation was obviously a rate for essentially "riskless" money. On December 31, 1966, the bank prime rate was 6%.† It is obvious on its face that this rate could not reflect any of the practical business risks involved in the investment of

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Financial Logic of Investment Property Appraising, The Real Estate Appraiser, pp. 13, 16 (May-June 1969). One writer, as far back as 1965 when money rates were far lower than today, stated that a real estate investment "should show a yield of around 12% to 15% or better on the buyer's equity investment in the property." Graham, *Owner's Analysis of Yields on Major Real Estate Investments,* The Appraisal Journal, pp. 541, 543 (Oct. 1965).

* App. 487-88c.

** A recognized authority in the field has noted that raw land generally receives only a 50% loan. *Interest Rates, Land Loans, Some Angles That Worked, Trends,* 1967-1968 National Real Estate Handbook & Directory, pp. 59, 61 (1968); Weinberg, *Techniques for Lenders,* National Real Estate Investor, pp. 44-45 (Dec. 1965) (pointing out that Title X of the 1965 Housing Act does not permit borrowing in excess of 50% of the appraised value of raw land).

*** NHI-41, p. 9; T. 23294-95.

† NHI-92, p. 13.

capital in the New Haven land with the hope of realizing the predicted proceeds of the six-year marketing program.*

The composite rate of 10.5% which the Commission applied in order to discount net land proceeds is clearly reasonable and, indeed, low.**

B. *The Commission's adoption of a discount was not erroneous as a matter of law and does not depend upon any assumption that in a hypothetical liquidation the New Haven would or could be compelled to sell its real estate properties to a bulk purchaser.*

The Reorganization Court apparently concluded that, as a matter of law, the Commission was bound to accept the total of the separate appraisals of the over 3,000 parcels and could not make any allowance for the fact that the individual parcels had to be sold over a six-year period.***

The Reorganization Court cited no decisions that support the proposition that in valuing the mass of real property owned by the New Haven the Commission was precluded, as a matter of law, from making a reasonable allowance for the risks involved in selling it piece-by-piece over a six-year period. On the contrary, the Commission's approach to the problem is supported by numerous decisions giving appropriate weight to such risks in the case of a large tract of land.

The typical means by which courts take account of these risks is by hypothesizing a sale of the entire tract as it exists on the valuation date to a willing buyer in a single

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* For a discussion of the factors involved in determining the proper interest rate or capitalization rate for discounting future proceeds from the sale of parcels carved out of a large tract of vacant land, see *Encyclopedia of Real Estate Appraising*, pp. 716-17 (E. Friedman ed. 1968).

** Beaton, *Corporate Investment in Real Estate*, Lawyers Title News, pp. 12, 13 (Aug. 1969) ("Prime real estate will yield a before-tax return on total investment, including equity and debt, of from 8 to 15 per cent or more.")

*** 304 F. Supp. at 805, App. 292-93a.

transaction on that date.* Numerous decisions hold that it is not appropriate to value an entire tract of land merely by aggregating the predicted selling prices of separate parcels into which the land might be subdivided, but that the value is to be determined by what a willing purchaser would pay for the entire tract before subdivision.**

The Reorganization Court's ruling of law is thus at odds with judicial precedent and economic reality. Its error

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* *United States* v. *3.544 Acres of Land*, 147 F.2d 596, 597, 599 (3d Cir. 1945); *Pennsylvania Schuylkill Valley R.R.* v. *Cleary*, 125 Pa. 442, 452, 17 A. 468, 470 (1889); *State* v. *Tedesco*, 4 Utah 2d 248, 291 P.2d 1028, 1030 (1956); *State* v. *Riley*, 143 So.2d 396, 399 (La. App. 1962); 4 Nichols, *The Law of Eminent Domain*, ¶ 12.1, 12.23 (rev. 3d ed. 1962).

** *State* v. *Tedesco*, *supra*, 291 P.2d at 1029; *State* v. *Riley*, *supra*, 143 So.2d at 399-40; *State Dept. of Highways* v. *Rapier*, 246 La. 150, 164 So.2d 280, 286 (1964); *Encyclopedia of Real Estate Appraising*, p. 698, 716-17 (E. Friedman ed. 1968); *McMichael's Appraising Manual*, pp. 217-18 (4th ed. 1951); Kahn, *The Entrepreneur—The Missing Factor*, The Appraisal Journal pp. 472, 476 (Oct. 1963). In a case involving the question of how to compute damage caused by the taking of a part of an entire tract of land, *State* v. *Malecker*, 265 Minn. 1, 120 N.W.2d 36 (1963), the Supreme Court of Minnesota approved a ruling of the lower court to the effect that:

> "[W]hat we are concerned with is what might be called the *wholesale* value of this property. That is, selling the entire property as one big unit rather than selling the individual lots separately. . . ." 120 N.W.2d at 37-38.

The Minnesota Supreme Court concluded:

> "Market value is not to be determined by a myriad of separate transactions where there are numerous buyers negotiating for the purchase of individual lots over a long period of time. *What we are concerned with is the price which an individual purchaser would pay for the entire tract in a single transactions.* . . ." 120 N.W.2d at 40 (emphasis added).

appears to arise at least in part because of the Reorganization Court's fallacious reasoning that the Commission's valuation was improper because there was "nothing in the record to show" an "existing market" for the totality of the New Haven's land on the valuation date.* The Court failed to recognize that, in calculating the market value of the land as a whole, it was proper to determine what a willing hypothetical buyer would pay for the land as a whole without regard to whether an actual bidder for all the land could be found.** The hypothetical "wholesale" buyer is simply an analytical device for approximating risks that would occur if the land were retailed over time as promptly as possible, starting on the liquidation date.

Closely related to the argument that no bulk buyer exists is the criticism of the bondholders that the Commission's approach improperly "postulates a middle man"*** and the Reorganization Court's charge that the Commission's result "is predicated on the fact that Penn Central is purchasing all of the New Haven's assets at one time."† Again, these contentions are erroneous. The hypothesizing of a purchaser on the valuation date is purely a part of the process of determining fair market value in the hands of the owner, under the standard definition of market value. And the Commission's determination is not dependent on the actuality of the bulk sale to Penn Central. Instead, it represents an acceptance of the Simon testimony as to the method an experienced businessman would use to value the entire New Haven land on the valuation date.‡ It is simply a determination of the price a prudent pur-

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* 304 F. Supp. at 797, 805, App. 279a, 292-93a.

** 4 Nichols, *The Law of Emminent Domain*, ¶ 12.2 [2] (rev. 3d ed. 1962).

*** Mfrs., p. 53; Committee, pp. 91-92.

† 304 F. Supp. at 805, App. 292a.

‡ It would make no difference in the calculation of fair market value what method of disposition is postulated. The fair value of the land in the owner's hands is not a variable which will move up or down according to the choices made by the owner as to the manner of disposition.

chaser would pay who had to undertake the marketing program and the price a prudent seller would accept who could avoid it.

C. *The remaining points of the Reorganization Court and bondholders are without merit.*

Another criticism of the Reorganization Court was that there would be a "double deduction" if the bulk sale discount were allowed. The Court proceeded on the mistaken ground that "the computation in arriving at fair liquidation value has already deducted $8 million *for this purpose.* . . ."* Simon's direct testimony expressly recognized the existence of the prior $8 million deduction, described it properly,** and, with full understanding of the nature of the prior deduction, the witness nevertheless concluded that the further deduction was necessary to quantify the overall risks involved in holding and disposing of the New Haven land as a whole.

Beyond this, an examination of the bases of the $8 million write-down of certain appraisals shows clearly that it dealt with a different matter from the subject of Simon's testimony. The write-down related to specific hard-to-sell acreage (referred to in other testimony as the "cats and dogs"***). These were particular parcels iden-

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* 304 F. Supp. at 805, App. 293a (emphasis added). The dissenting opinion of the Three-Judge Court also claimed there was "an unwarranted duplication". The three bondholder briefs make reference in varying degrees to the $8 million deduction. Mfrs., p. 51-55; Committee, p. 91 fn.; Chase, p. 66.

** App. 347-48c. His stated assumptions included:

> "(4) That, in recognition of the difficulty of selling certain undesirable parcels, and the advantages of bringing the liquidation period to an end, the appraised value of the land estimated to be unsold at the end of the fourth year has been marked down substantially, for purposes of estimating the gross proceeds of the fifth and sixth year of the marketing period."

*** T. 23675.

tified by Mason.* The write-down was, in effect, a revision of the estimated selling price of certain parcels which were overvalued in the context of a realistic marketing program. The write-down reflected *known* factors applicable to particular parcels, such as inaccessibility and unfavorable topography, rather than *risks* involved in the entire program of disposition.** The risks of unknowns as to time and price would still apply to the revised prices of the written-down parcels.

Confirming the absence of any duplication is Mason's own concession that he had made no analysis of the proper discount rate for the future real estate proceeds.*** He obviously would not have so stated if his $8 million "cats and dogs" write-down had been intended to reflect the overall risks applicable to future proceeds.†

Finally, the bondholders attack the decision of the Three-Judge Court upholding the Commission's adoption of the discount on the ground that the Court relied upon a

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* T. 23784-85. The original appraised market value of these identified "cats and dogs" parcels (as determined by the New Haven real estate staff) was $11,177,632. (App. 115c.) Thus, even before the write-down, these identified parcels constituted less than 10% of the aggregate appraised value of all of the 3,000 parcels, which was $113,700,000. NHI-41, p. 14.

** App. 114c.

*** T. 23798. It should be recalled that Mason acknowledged that the discount rate should recognize the risks of realizing the predicted proceeds. See footnote 1, p. 47.

† Manufacturers is, we submit, totally in error when it says that "the evidence . . . shows that the valuation originally developed by the Commission took all of the risks into account." Mfrs., p. 51. The "evidence" referred to consists solely of the facts that selling expenses were deducted (which obviously had nothing to do with risks), the "cats and dogs" write-down had been applied (which is discussed above), and the 6% discount had been applied. Simon's testimony expressly assumed all of these steps had been taken. Chase (p. 66) makes a similar irrelevant reference to the prior deduction for the marketing expenses.

"theory . . . altogether different from the one actually relied upon by the Commission, a practice which this Court condemned in *S.E.C.* v. *Chenery Corporation,* 318 U.S. 80, 94 (1943)."*

This argument rests on the fact that the Three-Judge Court read a portion of the Commission's report as asserting that it had authority to compel a bulk sale of the New Haven properties for less than their liquidation value to a buyer who would continue the operation of the New Haven service. In the courts below, counsel for the Commission did not construe the Commission's report as asserting any power of this character but rather as asserting a power to compel a bulk sale at realistic liquidation value.** It cannot be disputed that the Commission has such a power.

But even if the Commission's discussion is given the broader reading adopted by the Three-Judge Court, that Court properly treated the assertion of authority as unnecessary to the validity of the Commission's determination.

The Commission found that under the discount "the bondholders will receive the full economic equivalent of the liquidation value of the assets" and that the discount "fully recognizes, without conceding, NH's right to abandon and liquidate the estate." Thus the Commission in this case did not exercise any asserted power to compel a sale at less than liquidation value. It follows that, even if the Commission were in error as to the existence of the power, the error "had no bearing on . . . the substance of decision reached". *Massachusetts Trustees* v. *United States,* 377 U.S. 235, 248 (1964). For these reasons the bondholders' reliance on *Chenery* is misplaced.

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* Mfrs., p. 51; see Committee, p. 87; Chase, p. 24.

** R. Doc. #22.

III. The Commission's evaluation of the probable scope of future rail service to the New Haven's Bronx freight yards under the hypothesis of liquidation has a reasonable basis in substantial evidence.

The sole issue with respect to the New Haven's Harlem River and Oak Point freight yards (the "Yards") in the Bronx, New York, was whether the Commission relied on substantial evidence and acted reasonably in its choice of the second of two appraisals of the Yards made by the same witness, Arthur J. McCann. At the outset of the discussion of this issue it is appropriate to observe that the merit of the Commission's rejection of the higher appraisal is demonstrated by evidence that prior to inclusion the New Haven in fact sold a 600,000 square foot portion of the Oak Point Yard at a unit price which is the equivalent of the unit price stated in the lower appraisal.*

McCann's second appraisal was prepared in late 1966 and was included by the New Haven Trustees in their liquidation study (NHI-45, p. 33), although they now disavow the appraisal in order to support the Reorganization Court's opinion. It was specifically directed to the conditions that would exist in the event of a liquidation of the New Haven. Thus, counsel for the Trustees specifically instructed McCann that he should predicate his appraisal upon the following assumptions:

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* The Trustees sold 600,000 square feet of favorably-situated upland area of the Yard at an average unit value of approximately $2 per square foot. (App. 92-103c, 204-05c, 389-91c—a map of the parcels sold is at App. 203c; NHI-56; NHI-57.) This property was sold to an industry to be served by rail. (App. 426c.) In the appraisal accepted by the Commission, the entire land area of the Yard was valued at $2 per square foot without rail service. (App. 72c—Parcel 3B.) Appellant's insistence that the Commission was bound to adopt McCann's higher appraisal, if sustained, would result in Penn Central paying $2.50 per square foot for the parcels sold, which is $.50 per square foot (or a total of $300,000) more than the New Haven actually realized on land sold prior to inclusion. (See App. 76c, 389c.)

> "That the New Haven Railroad had ceased to exist. That the tracks were to be removed. Power was to be shut off, there being no power and electricity in the yards, and I was to appraise the property as an industrial facility without any railroad service." (App. 383c; see 334 I.C.C. at 42, App. 129a)*

It is important to understand the meaning of these assumptions as they bear upon the conditions which would exist in the area of the Yards if the New Haven were to be liquidated. They mean that in those circumstances (1) there would be total abandonment of New Haven service in that area pursuant to an abandonment certificate issued under Section 1(18) of the Interstate Commerce Act, including all freight service from New Haven and points east and north on the New Haven line; (2) the Hell Gate Rail Bridge over the western end of Long Island Sound would be dismantled and scrapped** and would no longer be avail-

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* These were the same ground rules furnished to each of the appraisers participating in the Trustees' liquidation study. (App. 213-16c.)

The fact that, at the time of McCann's appraisal, he was unaware of an interchange track connecting the New Haven to a Penn Central line—a point stressed by the bondholders and even deemed worthy of mention by the Reorganization Court (304 F. Supp. at 807, App. 296a)—is lacking in significance because McCann did not formulate his own assumptions; he was instructed to follow the liquidation assumptions referred to in text.

** William Gordon testified for the Trustees,

> [W]e have assumed here that the New Haven and all of its leased lines and the New York Connecting would be liquidated and scrapped and our whole study is on that thesis and assumption. . . .
>
> ". . . I can't quite visualize sufficient use from a railroad standpoint for the [Hell Gate] bridge. . . . [T]here just isn't enough freight traffic on Long Island to justify maintaining any such structure as that." (T. 23320-21.)

In view of this testimony, it is remarkable that the Committee (p. 146) should charge Penn Central's witness with erroneously assuming the bridge would be torn down.

able for the movement of rail traffic to the Bronx from Long Island and from the so-called harbor carriers which float their traffic to Long Island from New Jersey and Pennsylvania*, (3) the existing joint Penn Central-New Haven tariffs would be terminated, thereby freeing Penn Central of its legal obligation to accept freight traffic destined for the Hunts Point market and the area of the Yards, and (4) anyone wishing to provide rail service in lieu of that abandoned by the New Haven would have to purchase from the New Haven or construct the tracks and facilities necessary to afford access to the Hunts Point market and the Yards.

The appellants contend that the Commission was required to reject McCann's second appraisal and accept his first appraisal (higher by $4,439,000), which was not prepared upon the liquidation hypothesis. On the contrary, he appraised the Yards "as . . . freight yard[s] of an operating railroad as of June 15, 1965" (App. 63c) and assumed that each "yard was being adequately and economically served in its entirety by the New Haven Railroad." (App. 384c.)** In the remand hearings, McCann testified that the values stated in his first appraisal would be representative of the situation in liquidation of the New Haven only "if the *same*

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* The Committee's reference (p. 146) to traffic of "more than 100 cars per day" to industrial customers in the area of the Yards is misleading if intended to suggest that this condition would exist if the New Haven were liquidated. The record shows that these 100 cars moved into the area via either the Hell Gate Bridge or the New Haven's main freight line, both of which the Trustees' evidence shows would be scrapped in the event of liquidation.

** By "railroad service", McCann meant that "a siding could be provided for the use by any occupant in any part of the yard." (App. 391c.) By "siding", he had in mind the conventional side track arrangement by which shippers in all parts of the freight yards were being served by the New Haven at the time of his appraisal. (App. 385c, 391c.) He did not assume that shippers would be required to purchase land in order to obtain rail service—"they don't do anything but receive the goods and ship them out." (App. 385-86c.)

services as provided by the New Haven Railroad could be provided by somebody else". (App. 392c; emphasis added.)*

In support of the first appraisal, the appellants contend that, because of the proximity of a Penn Central line to the Yards, the Commission should have assumed that Penn Central would either voluntarily provide rail service to the Yards or would be compelled to do so if the New Haven were liquidated. After a careful appraisal of the evidence, the Commission rejected this contention and specifically found that in the event of a liquidation of the New Haven, "Penn Central would not serve, and could not be compelled to serve, the Harlem River or Oak Point industries, or the Hunts Point Market." 334 I.C.C. at 47, App. 134a.**

The Commission's finding is not only supported by substantial evidence but is indeed required by the weight of the evidence. An executive of Penn Central, Weaver, who is responsible for making recommendations concerning extensions of Penn Central service into new areas (App. 341c, 398c), testified that Penn Central would not provide rail service to the area of the Yards if the New Haven were liquidated because the rail traffic via the Penn Central line to that area is unprofitable to Penn Central and because substantial costs, both in terms of monetary expense and outlay of engineering time and effort, would be required to provide the service.

Weaver testified that the then current (*i.e.*, pre-inclusion) traffic moving via the Penn Central line to the New Haven stations in the area of the Yards was predominantly traffic in perishable commodities destined for Hunts Point

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* McCann not only reiterated this point, but further inquiry was halted because the Hearing Examiner agreed with Trustees' counsel that "he answered it when he says, the same." (App. 393c.)

** The Commission also concluded it was unlikely that any other carrier would provide the service. 334 I.C.C. at 44, 47, App. 131a, 134a. The appellants' briefs do not appear to contend that the Commission was obliged to accept the speculations of bondholder witness Shannon to the contrary.

market. (T. 29414; App. 398c.)* This testimony was substantiated by that offered by the bondholders.**

Weaver further testified that the perishable traffic is unprofitable to Penn Central.*** This testimony was based on a 1967 traffic study by Penn Central's Director of Cost

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* The Hunts Point market in the Bronx, New York, is a fruit and vegetable market constructed by the City of New York. (NHI-39, p. 29.) The market receives traffic in perishables from the far west, the southwest and the southeast portions of the United States. (T. 23255-56.) It is not located in the two Yards but is located about two miles north of the Oak Point Yard (R-16, pp. 4-5) and four miles north of the Harlem River Yard. It receives rail traffic from the New Haven via a spur track connection to the New Haven's freight line between New Rochelle, New York and the Hell Gate Bridge. (See map at App. 511c.)

** Bondholder witness Shannon's traffic figures for August 1968 revealed that, of the 2,328 cars interchanged to the New Haven at the Penn Central interchange track, 1,127 contained perishables destined for the market. (App. 331c, 405c.) Of the remaining 1,201 cars, approximately 8% (about 186 cars) were empties and one-half (600 cars) did not terminate in the area of the Yards, but moved on to other New Haven destinations (which under the liquidation hypothesis would not exist). (T. 29688-89.) Thus, only 415 cars (about 13.3 cars per day) were delivered to industries in the area of the Yards in that one month. See 334 I.C.C. at 45, App. 132a.

*** App. 397-403c. Weaver was asked, in effect, whether Penn Central would make the expenditures to perform the service if it could derive a profit. He responded affirmatively, adding "But I wouldn't recommend it on what I have right here." (App. 397-98c.) He made clear that he was referring to the preponderance of the present traffic being in perishable commodities. (App. 398c.) He later reiterated, in response to a question whether Penn Central could give up the Hunts Point market, that: "I will recommend that they do that on the basis that I don't think it's a profitable proposition for a capital investment of that size." (App. 403c.) Without abandonment of New Haven service, Penn Central was bound by its joint tariffs with the New Haven to accept the perishables traffic destined for Hunts Point market (App. 427c); such abandonment would have relieved Penn Central of that obligation. 334 I.C.C. at 132a, App. 132a.

and Profit Analysis.* In addition to testimony of Weaver, there was other evidence as to the extra cost of handling this perishable traffic. (T. 23255-63, 23352-53, 24547, 29695.) There was, therefore, substantial evidence to support the Commission's finding that the perishable traffic would not be profitable.** That finding did not rest solely, as appellants suggest, upon the materials set forth at page 46 of the Remand Report (App. 133a) which, as the Commission noted, merely "supported" the Penn Central testimony. (App. 132a.)

Appellant presented no evidence to contradict the evidence of Penn Central that the perishable traffic was not profitable. Shannon, who testified for the bondholders, did not dispute Weaver on this point. Shannon admitted that he did not investigate the profitability of the traffic to Penn Central (App. 408c, 424-25c, T. 29684-85), and simply attempted to dismiss profitability as "one of the insignificant inputs as to whether or not Penn Central would serve this area." (App. 428c.) With the record in this state, the attempt of Manufacturers (p. 71 fn.) to disparage the evidence of Penn Central on the issue of profitability does not even rise to the level of a quarrel with the Commission over the weight of the evidence. There simply was no evidence that the traffic is or would be profitable.

Weaver also testified to the heavy cost to Penn Central, both in money and engineering time and expense, of attempting to provide physically adequate and economic service if the New Haven service were abandoned. His testimony enumerated several areas of capital and operating

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* App. 398-400c. It is ironic that Manufacturers (brief, p. 71 fn.) should rely on Weaver's not describing the traffic study when, in fact, it was Manufacturers' own counsel who cut off inquiry as to the study's results, stating: "I am not interested in it." (App. 400c.) Under the ground rules of the expedited remand hearings, Penn Central was not permitted a right of redirect examination with respect to Weaver's testimony.

** It should be noted that the Reorganization Court, perhaps drawing in part on experience in the New Haven bankruptcy, referred to the "I.C.C. . . . policy of forcing the railroads to handle perishable produce at a loss." 304 F. Supp. at 808, App. 297a.

expenditures. For example, he testified that if the New Haven were liquidated and Penn Central should attempt to supply rail service to the Yards, it would encounter substantial difficulties and costs because of clearance restrictions on the weight and height of freight cars.* The bondholders' witness, Shannon, did not deny the existence of the problems created by the clearance restrictions but simply asserted that there would be "means available to correct them". (App. 419c; 415-22c.) He was vague about the asserted means of correction and admitted that he had not investigated the costs that they would entail.**

Weaver also testified that Penn Central would have to acquire the yard facilities to perform the switching, classification and holding of car operations required to serve the area of the Yards.*** Shannon did not dispute Penn Cen-

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* App. 344-45c; T. 29400. Weaver testified that the industries most likely to be located in the Yards would probably use high cube-type freight cars in order to secure more favorable rates and that these cars could not pass the clearance restrictions on significant segments of the Penn Central lines. (App. 344-45c; T. 29400; see App. 333c.)

** App. 419c. Shannon conceded that the bulk of the high cube freight cars would not be able to negotiate the restrictive clearances on Penn Central's former Port Morris branch and that he had no information as to a Plate C car over 15'2" passing over that branch. (App. 420-21c; see R-46 and App. 416-17c.) These clearance restrictions consist of overhead bridges made of steel and reinforced concrete which principally support public streets. (App. 416-18c.) Moreover, as Weaver indicated and Shannon acknowledged, the clearance restrictions were not limited solely to the former Port Morris branch; Penn Central's Hudson Division and Harlem branch lines (see map at App. 511c) are also subject to such restrictions. (App. 344-45c, 418-19c.)

*** App. 344c. The refined classification required for customer delivery of this traffic was not, prior to inclusion, performed by Penn Central. Penn Central delivered the cars unclassified to the New Haven at Port Morris and the New Haven performed the classification of these cars at its Oak Point Yard. (App. 342c; 334 I.C.C. at 44 n.19, App. 131a.) Under the liquidation hypothesis, the Oak Point Yard would not be available for classifying and switching this traffic unless Penn Central were willing to purchase the Yard for this purpose.

tral's lack of yard facilities in the immediate switching district, but asserted that Penn Central could perform the refined customer classification of cars "several hundred miles" away at a yard at Selkirk near Albany, New York.* While Shannon also postulated the use of "certain, presently undefinable portions of the yard properties" for this purpose (App. 337c), he added that "until you knew exactly what the operating plan was it is hard to predict exactly how much at Oak Point you would have to retain." (T. 29715.) He made no cost estimate of acquiring the necessary land and trackage. (T. 29716-17.)

The record contains evidence with respect to other costs that Penn Central would have to incur if, upon a liquidation of the New Haven, it should attempt to provide service to the Yards and the Hunts Point market. These include the cost of: (a) acquiring trackage from the Penn Central boundary at 149th Street in the Bronx north to a point above the Hunts Point spur track,** and south to the East 132nd Street entrance to the Harlem River Yard (T. 29716; see map at App. 511c);*** (b) maintaining the switch crews

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* App. 411c. Shannon relied upon a 1962 statement in testimony in the Penn Central merger proceedings that the Selkirk Yard could classify traffic "*virtually* to the customer's door in New York City" and elsewhere (App. 412c; emphasis added; see T. 29682) without any effort to ascertain what the term "virtually" signified. (App. 413c; T. 29482.) He was totally ignorant of the classification and switching problems involved. (T. 29475-77, 29650-58, 29670-83, 29685.) Weaver testified that he was familiar with the Selkirk Yard's capabilities and that it could not classify and pre-block cars moving to industrial consignees at points distant from the Selkirk Yard. (T. 29436-37.)

** Since a reverse movement of cars is required to enter the spur track into the market, trackage north of the market would have to be purchased. (T. 29650-52.)

*** With uncharacteristic generosity, the Committee brief (p. 150) now says: "If necessary, the track would have been donated." However, no offer is made to reduce the higher valuation by the $500,000 right-of-way to which the Committee refers. (The figure derives from McCann's valuation in his *lower* appraisal of the land *sans* track sold for industrial usages without rail service—Parcels

and facilities required to switch the traffic to the former New Haven areas (T. 29479, 29656-58, 29685); and (c) maintaining the former New Haven tracks and related services, such as locomotive fueling, car inspection and way billing facilities (see App. 343c; T. 29417-18).

This review of the record shows that there was substantial evidence to support the Commission's finding that, in the event of the liquidation of the New Haven, Penn Central would not serve the Yards. Indeed, in the face of the evidence, the Commission could not reasonably have accepted the contrary assertions of Shannon who was in no position to speak authoritatively with respect to the practices or intentions of Penn Central, who had made no study of potential traffic in the area of the Yards (App. 426-27c) and whose predictions rested in large part on speculations of a doubling of the Hunts Point traffic if the market should be expanded. (App. 427c.) This speculation, even if given weight, is of no significance since an increased volume of perishable traffic would only mean an increased deficit for Penn Central.

Shannon's testimony rested heavily on the assumption that Penn Central could legally be compelled to perform the services. (T. 29658-60, 29704, 29713.) This assumption was incorrect. Under Section 1(21) of the Interstate Commerce Act, Penn Central could not have been forced to serve the Yards.* Furthermore, the Commission found that the record did not support a need for Penn Central service to

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2 and 3A at App. 70-71c and see App. 386c.) There is also no mention of the rail and other track materials on that right-of-way which were included in Gordon's liquidation figures, or of the cost of acquiring the portions of the Yards needed for continued rail service.

* See *ICC* v. *Oregon-Washington R.R. & Nav. Co.*, 288 U.S. 14, 35-39 (1933). Penn Central's own line haul rate extended only to its boundary line at East 149th Street in the Bronx (App. 398c) and it had never undertaken to serve stations in the New Haven's Bronx station area.

the Yards that would justify the additional costs and expenditures that Penn Central would incur in furnishing it —a finding which clearly indicates that even if the Commission had authority to require the service the facts would not justify its exercise.*

The Three-Judge Court, which had initially suggested that the Commission should review its acceptance of the second McCann appraisal in the light of the proximity of the Penn Central line (App. 386a), noted the Commission's "careful reexamination" of the issue and sustained the Commission's adherence to that appraisal, holding:

> "The Commission's evaluation of the probable scope of future rail service to these properties in the event of liquidation of NH lies in an area peculiarly within its expertise, and we decline to disturb it." 305 F. Supp. at 1061, App. 423a.

The Reorganization Court, on the other hand, reversed its 1968 decision that there was substantial evidence to support the Commission's adoption of the second McCann appraisal** and held that "as a matter of law" the Commission was bound to accept the higher appraisal.*** With all deference to the Court's characterization of its conclusion, it seems clear that in reaching it the Court merely substituted its judgment for that of the Commission on the weight of the evidence relating to the probable scope of future service by Penn Central to the Yards.

The Reorganization Court gave no weight to the evidence that the perishables traffic was unprofitable and that service to the Yards by Penn Central would involve substantial additional costs. Instead, the Court adopted the premise that, if the New Haven were liquidated, the City or

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* Note that the need for the service is the criterion under Section 1(21) of the Interstate Commerce Act, 49 U.S.C. §1(21), in cases (unlike the instant one) where the Commission could properly require a carrier to extend its line.

** 289 F. Supp. at 464, App. 253-54a.

*** 304 F. Supp. at 809, App. 297a.

State of New York by political pressure would compel Penn Central to provide rail service to the Hunts Point market. From this premise the Court moved to the conclusion that it would be "unlikely that Penn Central could then deny a spur track connection to industrial owners and users of the property in question."

The Reorganization Court's premise is entirely speculative. No representative of New York City or any other political entity testified that, if the New Haven were liquidated, rail service via its lines to the Hunts Point market would be essential, that service could not be provided more economically by other means (as for example, by rail piggybacks trucked to the market*) or that some public agency would attempt to force Penn Central to provide the service.

But, as the Three-Judge Court pointed out, even if the premise were accepted, it "would not necessarily entail the conclusion necessary to compel adoption of the higher figure."** Service to Hunts Point market via Penn Central's former Port Morris branch would not pass the New Haven's Harlem River Yard, which lies in the opposite direction to the south. (See map at 511c.) The Reorganization Court assumed, erroneously, that the track between the Penn Central interchange and the Harlem River Yard would be maintained because the track connects with the Hell Gate bridge of the New York Connecting Railroad,*** in disregard of the Trustees' testimony that the bridge would be dismantled. See footnote 2 at page 63 above.

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* Charles Ragland, Vice President-Freight Traffic of the New Haven, testified that an original estimate by the U. S. Department of Agriculture (that 40,000 carlots of perishables would be received annually by the market) had been cut in half because of "TOFC" (trailer on flat cars, *i.e.*, piggybacks). (R-39, p. 29; T. 23231.) Even the revised 20,000 carlot figure proved to be high, as about 15,000 carlots is the present annual volume. (T. 29466.) Weaver mentioned piggyback service as an option open to the City if the New Haven were to abandon service to the market. (App. 401-02c.)

** 305 F. Supp. at 1061, App. 423a.

*** 304 F. Supp. at 807, App. 297a.

The Court's casual suggestion of "a spur track connection" overlooks the difficulties and costs that Penn Central would face in undertaking to provide service to the Harlem River Yard over the facilities of the New Haven. These problems would have included the purchasing of two miles of rail and superstructure from East 132nd Street to East 149th Street in the Bronx, establishing a terminal shipping operation complete with yard switching locomotives, car inspection, locomotive fuel stations and other related facilities (App. 343c; T. 29417-18) and purchasing and setting aside adequate land for switching, classification and holding of cars. (App. 344c.) Even if it is assumed that, because of political pressure, Penn Central would choose to serve the Hunts Point market, there is no reason to suppose that it would assume the substantial additional costs involved in serving the Harlem River Yard.

Although the Oak Point Yard is closer to the Penn Central interchange track, the problems of service to that Yard (again assuming Penn Central service to the Hunts Point market) are of the same nature as those involved in service to the Harlem River Yard. Penn Central would have been under no legal obligation to provide the switching or other facilities within or adjacent to the Yard that would be required to make service feasible and attractive to shippers and there is no reason to assume that it would have voluntarily assumed the cost of providing these services.*

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* The obligation of a common carrier with respect to a spur track connection on its line is merely to spot cars on the spur track beyond the clearance point of its line. "The tariffs publishing the line-haul and switching charges do not in terms or by any reasonable construction provide for 'plant switching' or 'spotting of cars at unloading points' to be performed at plant's convenience." *Ex parte #104, Practices of Carriers Affecting Operating Revenues & Expenses, Part II, Terminal Services,* 209 I.C.C. 11, 18 (1935); accord, *Sioux City Terminal Ry. Switching,* 241 I.C.C. 623, 624 (1940); *American Fuel Co.* v. *Atchison, T.&S.F. Ry.,* 123 I.C.C. 101, 112 (1927); *National Ind. Traffic League* v. *Aberdeen & Rockfish R.R.,* 61 I.C.C. 120, 121-22 (1921).

IV. The Three-Judge Court properly refused in settling its decree to consider the merits of a recalculation of the discount of liquidation receipts set forth in a bondholder letter based on asserted errors in the Commission's computation never presented to the Commission.

The bondholders contend that the Commission's computation of the discount of liquidation proceeds, based upon the testimony of the Trustees' witness Gordon (App. 206-07c), contains four specific errors. The bondholders assert that three of these errors improperly reduced the liquidation value of the New Haven by $3,658,545. The fourth error, they concede, improperly benefited the Estate and, on the basis of the testimony of their expert Altman (App. 366-73c), they assert that the amount of the benefit is $1,372,646. Consequently, the bondholders seek an upward revision in the liquidation value by the excess of the first figure over the second, or $2,285,899.* (App. 509c.)

The position of Penn Central has been and continues to be that the bondholders cannot now attack the Commission order on these grounds because they did not present the asserted errors either to the Commission or to the lower courts in timely fashion. Alternatively, if such errors can be urged belatedly, there is expert testimony of Penn Central's witness Hull (App. 355-65c) to the effect that the third alleged error is non-existent and the fourth error improperly benefited the New Haven by $3,325,065. The Hull testimony, which we submit had a far more substantial basis than the Altman testimony, reduces any net

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* This figure differs from the $2,415,899 figure in the Reorganization Court's order (App. 318a) by $130,000. The latter figure represents an updating of the original Gordon computation for valuation changes occurring thereafter, assuming that the Reorganization Court's valuation of the Bronx freight yards (see Point III above) is sustained. (App. 499-501c.)

The Commission's and the Three-Judge Court's updating figure of $410,000 accepts the Commission's valuation of the Bronx freight yards.

disadvantage to the bondholders to an amount that is insignificant in the context of this case.*

The Reorganization Court, disregarding Penn Central's argument that the errors asserted by the bondholders were untimely, in its order found and concluded "as a matter of law" that adjustments should be made as to all four of the asserted errors. (App. 318a.) Without adverting to the conflict in testimony regarding the third error and the amount of the fourth error, that Court accepted without explanation the figure based on the testimony of the bondholders' expert.

The Three-Judge Court, also confronted with the bondholders' assertion of the same four errors and the Penn Central's response that the merits of the contention were no longer open, held that "We have not passed on the merits of this contention [of the bondholders] since we do not consider it to be appropriately before us on settlement of the decree." (App. 445a.) The Three-Judge Court therefore declined to make any adjustment on account of the asserted errors and did not reach the question of differing expert testimony regarding the amount.**

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* On Hull's computation, the asserted "net error" in favor of Penn Central of $2,285,899 (App. 509c) falls to $215,480—$3,540,545 (first two errors harmful to bondholders) minus $3,325,065 (error harmful to Penn Central on Hull evidence). The Hull and Altman computations differed principally as to the years in which the anticipated liquidation proceeds would be received by the Estate.

** The Three-Judge Court recognized that the Reorganization Court had considered the four errors on the merits. It stated that "The difference in the treatment of this item [the asserted errors in the computation] by the two courts will be another matter for ultimate resolution by the Supreme Court." (App. 445a.) The bondholders' suggestion (*e.g.*, Committee brief, p. 140) that the Three-Judge Court by this language assumed that the errors should be resolved on the merits by this Court is not supported by the language, read in context. The issue the Three-Judge Court assumed would be resolved by this Court is whether the merits of the bondholders' asserted errors were still open to judicial scrutiny at this late stage.

The initial question for this Court, prefacing any consideration of the asserted errors on their merits, is whether they remain open for examination. Penn Central has consistently argued that the four errors could not be raised in either of the courts below because the bondholders failed to raise them before either the Commission or the lower courts at several earlier stages although there was ample opportunity to have done so. A continual reexamination of the issues previously settled would make the proceeding interminable. Accordingly, we submit that an examination of the facts and precedents confirms that the Three-Judge Court was correct in declining to consider these asserted errors.

All four asserted errors relate to the computation of the discount of liquidation proceeds, an issue at the initial inclusion hearings in 1967. The figures underlying this computation first appeared in the testimony of Gordon on January 25, 1967. (App. 206-07c.) His work sheets were then available to the bondholders upon request.* The Gordon figures were adopted in the Commission's Inclusion Report issued in November 1967 (331 I.C.C. 661-62, App. 19-20a). The computation was not attacked by the bondholders in proceedings in both lower courts to review the Inclusion Report, but the assertion was made that liquidation expenses should have been discounted if liquidation proceeds were discounted. In July and August, 1968, the reviewing courts remanded to the Commission with instructions to make a computation of the discount of liquidation expenses. 289 F. Supp. at 427-28, 461, App. 331-32a, 250a. At the Commission hearings on remand held in September and October, 1968, bondholder expert Altman gave testimony relating to computation of the discount of both receipts and expenses and Penn Central offered a similar computation through its expert Hull in rebuttal of Altman. The bondholders in the remand proceedings could

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* It is the Gordon work sheets which provide the basis for the bondholder present assertions of error.

readily have offered their present assertions but failed to do so.* The Commission in November 1968 issued its Fourth Supplemental Report reiterating the liquidation receipts discount figures previously based on Gordon's testimony, and discounting expenses as directed by the lower courts.**

It is even more apparent that the bondholders failed without justification to make their new assertions when they appealed the Commission's Report. Apart from the updating aspect, the Commission's present approach to the discount computation, including the asserted errors, was fully embodied in its Remand Report. Gordon's work papers were continuously available to the bondholders, as they had been during the 1967 hearings. Yet in neither their appeal to the Reorganization Court nor to the Three-Judge Court did the bondholders make their present argument. Rather, the bondholders argued that the Commission had failed to "update" the receipts discount by considering the effect of valuation changes made by the Commission and the reviewing courts after the Gordon

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* At the time of the remand hearings, the bondholders had been furnished the work papers underlying the Gordon computation of the discount of liquidation receipts presented a year-and-one-half earlier. (Reply Brief of Manufacturers, dated March 14, 1969, p. 65 fn., R. Doc. #65.) Nevertheless, these work papers were never presented to the Commission, and were presented to the Three-Judge and Reorganization Courts only as a late-filed "Correction" to Manufacturers' foregoing reply brief without comment as to their significance.

** Altman's testimony, in treating the discounting of receipts, employed the factual and accounting assumptions now advanced by the bondholders in connection with the presently asserted errors. Despite this testimony, the bondholders' briefs to the Commission in the remand proceeding in no way sought to attack the Gordon discount of receipts computation because of the errors now asserted. Moreover, when the Commission issued its Remand Report, it expressly declined to revise the Gordon receipt computations (334 I.C.C. at 40 n.17, App. 127a), yet the bondholders made no effort to seek a rehearing because of the errors asserted here.

computation.* Both courts accepted this contention in their opinions of May and June, 1969, and remanded to the Commission on this limited point.**

Following this second remand, the Commission recomputed the discount on updated receipt figures and on June 10, 1969, reported by letter to the Reorganization Court the resulting figures (App. 499-501c), most of which it embodied in its Fifth Supplemental Report in July, 1969. (334 I.C.C. at 529-30, App. 223-24a.) It was not until June 17, 1969, three weeks after the Reorganization Court's decision, that the bondholders for the first time actually raised the presently asserted errors. They did so by letter to Judge Anderson (App. 502-10c), and thereafter to the Three-Judge Court (R. Doc. #80), while the two Courts were preparing to enter their final decrees pursuant to the figures resulting from the Commission's updating recomputation. Under these circumstances, the Three-Judge Court was right in refusing to consider the bondholders' asserted errors and the Reorganization Court was in error in allowing this belated attack.

If participants in proceedings of the present kind were allowed at each subsequent stage to reopen conclusions and computations on grounds of asserted errors previously available and not raised, there would be no end to the proceedings. The present attack is upon testimony first given by Gordon over three years ago, followed by two appeals and two Commission reconsiderations on remand, and directly challenged in court on the present grounds only

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* *E.g.*, Committee brief, Jan. 17, 1969, pp. 76-79, R. Doc. #8, filed in both lower courts.

** The bondholders inaccurately read Judge Anderson's order of remand at this stage as calling for a general recomputation, rather than an updating, in order to embrace the errors now asserted. However, Judge Anderson's opinion specifically noted three post-Gordon valuation changes and expressly stated that new computation should be made *by the Commission* "based upon the changes made in the valuation items through and including those stated in the present opinion." 304 F. Supp. at 811, App. 302a.

after all these intervening steps. The difficulties of coordination attending a proceeding under review simultaneously in two separate courts make it especially incumbent upon parties to adhere to orderly procedure and to make their errors known at the earliest stage possible. This Court has repeatedly made it plain that allegations of error in administrative proceedings must be raised when first available rather than reserved for subsequent judicial review.* The Court should adhere to that requirement in this instance.

The principle that assertions of error must first be raised before the administrative agency is particularly apposite in this case where the existence of any [illegible] error involves the appraisal of conflicting testimony presented to that agency. It is not disputed by Penn Central that the first two errors asserted by the bondholders represent miscomputations in favor of Penn Central, nor is it disputed by the bondholders that the fourth error improperly benefits them. If the testimony of the Penn Central's expert Hull were accepted, instead of the testimony of the bondholders' expert Altman, there is no third error and the amount of the fourth error alone comes close to balancing the first two.

The Reorganization Court in its decree based its calculation of the amount of the fourth error upon Altman's

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* As the Court stated in *United States* v. *L. A. Tucker Truck Lines, Inc.*, 344 U.S. 33, 36-37 (1952), "We have recognized in more than a few decisions, and Congress has recognized in more than a few statutes, that orderly procedure and good administration require that objections to the proceedings of an administrative agency be made while it has opportunity for correction in order to raise issues reviewable by the court. . . . Simple fairness to those who are engaged in the tasks of administration and to litigants, requires as a general rule that courts should not topple over administrative decisions unless the administrative body not only has erred but has erred against objection made at the time appropriate under its practice." Accord, *United States* v. *Northern Pacific Ry.*, 288 U.S. 490, 494 (1933); *Unemployment Compensation Comm'n.* v. *Aragon*, 329 U.S. 143, 155 (1946).

testimony. It disregarded Hull's testimony, showing a much larger error in favor of the bondholders, without making any explicit finding, giving any reason or even adverting to the conflict in testimony. Even the briefest examination of the conflicting testimony indicates that Hull was far better qualified than Altman and that Hull's testimony is more probably correct and, in any event, the resolution of the conflict on this point was not properly a function of the Reorganization Court.

The existence of the third error and the amount of the fourth error turn upon an estimate of the period required for the disposition of certain New Haven assets. The assets include land, equipment, investments, materials and supplies, and Account 741 assets such as receivables written off the books as uncollectible. (Committee, p. 138.). While Altman's testimony summarily recites that he considered all these assets as saleable in a year on account of their nature (App. 371-72c),* Hull's testimony (App. 357-58c) examined the categories of assets individually and made particular computations of the appropriate discount for each of the categories.**

Hull explained in his testimony why he believed his assumptions as to the time of disposition of the assets were more realistic than those made by Altman. For example, Hull pointed out that "the New Haven's aging passenger

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*Notwithstanding this statement in his direct examination, Altman conceded on cross-examination that he knew the nature of these assets only by their title, that he had "not looked into them further", and that "I did not make an analysis of each individual asset, no." (App. 438c; see App. 432-48c.)

**Hull treated the freight equipment as disposable in the first year and the passenger equipment as disposable in the second year, the materials and supplies and the Account 741 assets as disposable in the first three years, and investments as disposable primarily in the first and third years. (App. 358c.) As to each category he made estimates as to the amount of the receipts in each of the years in which they were spread.

car fleet cannot be effectively disposed of in the first year of liquidation," as Altman's testimony assumed. (App. 358c.)* The correctness of Hull's approach is confirmed when it is recognized that the receipts in question also include such items as sales of materials and supplies spread out over the entire railroad (NHI-42, pp. 2, 5), a collection of bad debts so uncollectible that they have been written off the New Haven's books (*id.* at 34, 35) and realization of investments in transportation companies which would themselves have to be liquidated if the New Haven were liquidated (*id.* at 8-11).

It is thus clear beyond dispute that the argument of the bondholders cannot be accepted without rejecting the testimony of Hull in favor of the testimony of Altman and this in face of the fact that Hull's evidence was far more persuasive. With the issue in this posture, we submit that this Court should hold that none of the above asserted errors is now open for consideration.

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* At the initial inclusion hearings, Penn Central called an expert on the purchase and sale of passenger equipment, Milton Edwards. His firm purchased the entire fleet of the Lehigh Valley when it went out of the passenger business and was the largest supplier of all types of passenger equipment to Mexico. (NHI-123, pp. 2-3.) Mr. Edwards testified that: "Fundamentally, there is no significant market within the United States for the sale of used passenger equipment" and that "the Mexican market has approached the saturation point. . . ." (*Id.* at pp. 3-4.)

PART TWO

ISSUES INVOLVING AGREEMENT BETWEEN THE TWO REVIEWING COURTS

I. The Commission's valuation of the Penn Central stock, as supplemented by the underwriting formula and approved by both reviewing courts, is supported by substantial evidence and more than fair to the New Haven bondholders.

The Commission's valuation of the Penn Central stock, based primarily on prospective earnings, was upheld on the first appeal by both reviewing courts. On remand the Commission adhered to its $87.50 per share valuation. The General Income bondholders have consistently refrained from attacking the $87.50 valuation. On the second appeal, the First Mortgage bondholders sought to have the Penn Central stock valued at 63⅜ per share, which was its stock market quotation on December 31, 1968, the date of inclusion.* On this basis, they claimed the right to a payment of an additional $23 million.

Rejecting the bondholders' claims, the reviewing courts approved the $87.50 per share valuation again, but with an underwriting formula designed to assure the bondholders of the opportunity to realize $87.50 per share, no later than February 1, 1978.** The Commission adopted the underwriting formula.***

The underwriting formula has a second feature which removes the normal risks of equity ownership for the New Haven Estate. This second feature protects the bondholders

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* Mfrs, reply brief to both reviewing courts, dated Mar. 14, 1969, R. Doc. #65; Committee opening brief to both reviewing courts, dated Jan. 17, 1969, pp. 62-71. R. Doc. #8.

** 304 F. Supp. at 809, App. 299a, 300a; 305 F. Supp. at 1064, App. 429a.

*** 334 I.C.C. at 532, App. 226a.

against any downward drop in the market, below the 63⅜ inclusion date price, assuming the decline persists until February 1, 1978. Thus, the underwriting formula has the effect of enabling the bondholders to enjoy the best of all worlds—(1) an equity position with an "upside" guaranty of a specified price increase (from 63⅜ to 87½), plus the opportunity of still further "upside" gains without any limitation, and, at the same time, (2) a covenant in the nature of a contingent obligation, or a "downside" guaranty of no loss.

The present posture of the bondholders is, quite understandably, that they want to keep this extraordinary dual status. Accordingly, they no longer ask for a $23 million payment unaccompanied by the underwriting formula. They now embrace the underwriting formula, because of its potentially valuable protection against downside risk, but they also ask for still more—in effect, an advance payment of compound "interest" on the differential between 28-15/16* and 87½, computed over the period from December 11, 1969 to February 1, 1978.** On this basis they arrive at a figure of $23.3 million and ask to be paid this amount in Penn Central stock valued at 28-15/16. For the reasons stated below, this claim is wholly without merit.

A. *Background of the issuance of Penn Central stock in the New Haven reorganization.*

During 1964 the New Haven Trustees bargained at arms' length with the officials of Penn Central for the consideration to be paid to the Estate for the New Haven assets. They sought to have as much of the consideration as possible paid in the form of Penn Central stock, in order that the New Haven Estate might participate in the anticipated benefits of the Penn Central merger and the operating sav-

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* The price the day Penn Central's time expired for appealing the Three-Judge Court decree embodying the underwriting formula.

** Mfrs., pp. 67-68.

ings expected to result therefrom.* In its initial Report approving the Penn Central merger, the Commission found that eight years after consummation of the merger it would produce savings in excess of $80 million annually for the new company.** This was one of the fundamental premises of the April 6, 1966 decision of the Commission approving the merger. Consistent with this, the New Haven Trustees in 1967 formulated a reorganization plan which was keyed to the period of realization of the merger savings.***

A principal feature of the plan was the creation and continued existence for at least seven years of a New Haven investment company, with the purpose of holding the Penn Central stock during the life of the investment company.† Thus, the plan recognized the close relationship which exists between the value of the Penn Central stock and the achievement of the merger savings in the future.

It is against this background that the action of the Commission and the courts below with respect to valuation of the Penn Central stock should be considered. It was never contemplated that the Penn Central shares would be marketed on the inclusion date. On the contrary, as here-

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* Testimony of Trustee Kirk, NHI-65, pp. 15-16; Testimony of Trustee Smith, App. 21c; memorandum as to negotiating session of Nov. 9, 1964 (NHI-9, pp. 1-5). See Chase, pp. 91-92.

** 327 I.C.C. at 501-02. It should be noted that the Commission did not find or assume that the full amount of the merger savings would be achieved immediately after the merger or even in the years immediately following its consummation. In substantial part the savings depended on a capital expenditure program which would not be completed until four years after the consummation of the merger. 327 I.C.C. at 489-91. The Commission subsequently noted that the task of implementing the Penn Central merger would be "vast and complex". 328 I.C.C. at 312.

*** App. 241-249c; 334 I.C.C. at 94, App. 181a.

† App. 245c; 334 I.C.C. at 94, App. 181a.

tofore stated, the fundamental premise was that the shares were to be held for at least the seven years while merger savings were being achieved.*

B. *The Commission's valuation method and the approval of the reviewing courts.*

The Commission's function with respect to the valuation of the Penn Central stock was to determine its inherent value—the value it could be expected to contribute to the New Haven reorganization.

The key feature of the New Haven reorganization plan is a merger of the debtor railroad into a larger system. The security holders of the debtor have received in exchange for their former holdings a "package" consisting of securities of the surviving carrier plus cash. Accordingly, the Commission's task here, as in the case of the more typical "internal" reorganization of a railroad, was to appraise the fairness of an exchange of securities.

In making the determination of value of the proposed interest in the continuing enterprise, the Commission properly looked to the future prospects of the business. Section 77(e) itself prescribes that the principal criterion of value shall be "the earning power of the property, past, present, and prospective." This Court has unequivocally established that future earning power is the major determinant of railroad security valuation under Section 77. *Group of Institutional Investors* v. *Chicago, M., St. P.&P.R.R.*, 318 U.S. 523, 540-41 (1943).

The Penn Central stock valuation, made by the Commission in 1967,** was based on the testimony of two experts offered on behalf of the New Haven Estate: Ora C. Roehl, a Boston-based consultant on financial and manage-

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* App. 247c (". . . the deferral period deemed appropriate to measure the worth of the securities of the merged Penn-Central system."); 334 I.C.C. at 94, App. 181a (". . . the securities should not be sold . . .").

** 331 I.C.C. at 688-90, App. 46-48a.

ment affairs and former Chairman of the Investment Committee of Empire Trust Company (App. 119-142c), and William J. Kirk, one of the Trustees of the New Haven and President of John P. Chase, Inc., a leading investment counseling firm which advises, among others, large mutual funds. (App. 143-150c.) Mr. Roehl reviewed in considerable detail the prospects of the railroad industry and the future of Penn Central; he made various projections of the earning power of Penn Central, and he considered the proper multiple to apply to the Penn Central earnings. Kirk considered all this testimony, made his own analysis and estimated that the range of the value of Penn Central stock would be $75 to $100 per share as of the inclusion date and selected the midpoint, $87.50 per share.*

The New Haven bondholders presented no stock valuation witnesses at the 1968 hearings.

The Commission reviewed the evidence, tested the reasonableness of the Trustees' valuation by an earnings projection based on 1965 earnings plus projected merger savings (reaching a capitalized result of $100 as compared with $87.50), and concluded that the Trustees' valuation was reasonable.

On appeal from the Commission's 1968 Report, the bondholders challenged the Commission's valuation of the Penn Central stock. *Both reviewing courts upheld the valuation in their 1968 decisions.* The Three-Judge Court dealt with the issue at length,** and the Reorganization Court concurred in the following terms:

> "(g) approval of the Commission's valuation of the Penn-Central stock at $87.50 per share, based upon its own calculation of the estimated future earning power of Penn-Central and upon the testimony of Trustees Kirk, a well qualified expert. There is no reason why recent fluctuations in the market value of these shares should change the disposition of the matter".***

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* App. 148-50c; T. 24316-17.

** 289 F. Supp. at 437, App. 351-52a.

*** 289 F. Supp. at 462, App. 250a.

On remand, the New Haven bondholders offered for the first time a witness as to stock value—Paul L. Howell. The Howell testimony, which asserted that the Penn Central stock should be valued at $65 per share, did not dissuade the Commission from adhering to the $87.50 stock price. Referring to Howell's testimony, the Commission noted that he "was unfamiliar with Penn Central's operating and financial plans and condition; gave undue weight to extraordinary expenses of the past; and generally neglected the future prospects of the company."*

Under the established standards of review this Court has held that it will not substitute its judgment for that of the Commission on the weight or credibility to be given to the evidence of one witness against another or on the inferences or conclusions to be drawn from the evidence.** The record amply supports the Commission's rejection of Howell's testimony.***

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* 334 I.C.C. at 68 n.40, App. 155a.

** *Consolo* v. *Federal Maritime Commission*, 383 U.S. 607, 620-21 (1966); *Illinois Central R.R.* v. *Norfolk & Western Ry.*, 385 U.S. 57, 69 (1966).

*** For example, the witness showed limited knowledge both of Penn Central and the railroad industry (T. 29562-66); had not read the Examiner's report in the Penn Central Merger case (T. 29545); had not conferred with any member of Penn Central management in at least four years (T. 29529); did not know when Penn Central's four non-railroad subsidiaries were acquired (T. 29554) or for what years they contributed to earnings (T. 29562), or how much (T. 29568-69). As a consequence, the witness relied on an earnings record of the past which included the pre-diversification years of 1961 through 1963. (R-42, p. 7.)

Moreover, the witness developed an earnings record using a *deficit* in 1967 pro forma earnings for Penn Central of $8.86 per share, whereas the pro forma 1967 earnings from operations were positive (in the amount of $3.10 per share), and he gave great weight to that negative earnings record in determining prospective earnings (T. 29550-51). The $11.96 per share difference, or $275 million, represented an extraordinary, one-time charge against earnings in recognition of obsolescence and other factors resulting from the act of merger. This special charge in 1967 obviously had no relationship to future earning capacity. (continued)

The bondholders' briefs erroneously assert that the second time around the reviewing courts "rejected" the Commission's adherence to its own prior valuation.* On the contrary, the Reorganization Court, in its May 28, 1969 opinion, specifically reaffirmed the validity of "the theory of giving recognition to an intrinsic value in the shares, which will be realized when the full economic benefits of the merger have been achieved", and specifically negated the notion that there was unfairness in the "87½ fixed for present calculations."** In its July 28, 1969 decree, the Reorganization Court specifically stated: "The value of the 950,116 shares of common stock delivered by Penn Central on December 31, 1968 to the Debtor is $83.1 million," or $87.50 per share, subject to the underwriting provisions.***

The Three-Judge Court said that its views "parallel those recently expressed by the reorganization court."† The Three-Judge Court at no point withdrew its own prior approval of the $87.50 valuation. The Three-Judge Court said:

> "It must have been expected from the outset that a large portion of the purchase price would consist of PC stock and that this would not be immediately sold but rather would be held by the reorganized NH as a major long-term participant in what was expected to be a great and successful railroad system. Spot fluctuations are therefore not decisive, especially when, as here, there are reasonable explanations for them, such as the unanticipated difficulties in working out the operating details of the merger and the prospect of PC's having to shoulder

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The witness also made no effort to trend or project the earnings of Penn Central's non-railroad subsidiaries (T. 29583-84), or to quantify the upward trend in Penn Central's real estate income. (T. 29580-81.)

* *E.g.*, Mfrs., p. 63-64.

** 304 F. Supp. at 809, App. 290, 300a.

*** App. 318a.

† 305 F. Supp. at 1064, App. 429a.

> NH losses at an earlier date and in larger amounts than had been anticipated. A reasonable time should thus be accorded to determine what the real value of PC stock is. On the other hand, in the last analysis the market is the true appraiser and, if anticipations, no matter how well founded, should not be achieved, a proper adjustment should be made. We find Judge Anderson's solution of this difficult problem to be admirable and direct that the order be modified as provided in his opinion.'"*

In its Fifth Supplemental Report, the Commission endorsed the principle of the underwriting formula.**

C. *The error of the bondholders' contention for valuation based solely on market quotations.*

The entire thrust of the bondholders' argument in relation to the value of the Penn Central stock is that the market quotation on the inclusion date must be taken as the measure of value. This argument is obviously fallacious.

To give market quotations overriding importance would disregard the legal standards of valuation established by Section 77(e) which specifically require the Commission to give due consideration "to the earning power of the property, past, present and prospective." To substitute a market quotation for the Commission's appraisal of prospective earning power would be wholly inconsistent with the Congressional intent in vesting valuation power in the Commission, based on specified statutory standards of value. *Group of Institutional Investors* v. *Chicago, M.St.P.&P.R.R., supra,* at 540-41.***

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* 305 F. Supp. at 1064-65, App. 430a.

** 334 I.C.C. at 532, App. 226a.

*** See also, *Pere Marquette Ry. Merger,* 267 I.C.C. 207, 238 (1947). ("In the discharge of our duty under the statute to find whether the terms and conditions proposed for the merger are just and reasonable, we cannot confine our inquiry to market opinion, but must give consideration to all relevant elements of value.")

The Commission was entitled to consider the fact that there had already been and might be in the future wide fluctuations in the market quotations for the Penn Central stock, as there had also been in the market price of the stock of Penn prior to the merger. The Penn stock high-low average for 1962 was 14½ and, with many intermediate fluctuations, rose to a high-low average of 62½ for the pre-merger year of 1967.* The price of the Penn Central stock on February 1, 1968, the day of the merger, was 57⅜, and it rose to 86 on July 12, 1968, and then began a decline. The Commission was justified in recognizing that these cyclical movements rendered market price an unreliable indicator of value.

In addition to the historic movements and swings, the Commission was entitled to consider that the market quotation for the Penn Central stock at the time of its decision, which followed the date of the Penn Central merger by less than nine months, was, for several reasons, an unreliable guide to the inherent worth of the stock. The Penn Central merger itself was (and still is) too recent to permit of market appraisal with the advantage of an established earnings record over a period of years; there simply had not been, in November of 1968, and there still has not been, an opportunity for demonstration of the capabilities of the new enterprise. The Commission was undoubtedly aware in the fall of 1968 of some of the start-up difficulties involved in implementing the largest merger in the history of private industry.** As previously noted, the Commission had predicted that the problems of implementing the merger would be vast and complex.***

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* Sources for high and low prices for the respective years: NHI-62, p. 10; NHI-72, p. 18; T. 23969 and published quotations in *New York Times.*

** These difficulties were soon thereafter publicly reported. *E.g.*, *Time Magazine*, Feb. 2, 1970, p. 67; New York Journal of Commerce, Feb. 24, 1969, pp. 1, 3, 21; *New York Times*, March 9, 1969, p. 93; *Forbes*, April 1, 1969, pp. 16-17.

*** See footnote 2, p. 84.

In addition to the start-up problems, the Commission was well aware of the alarming increases in the New Haven deficits immediately before the inclusion and was fully aware of the impact on the new Penn Central which would result from forcing the early inclusion. It was readily foreseeable that these factors were already depressing the price of the Penn Central stock in the market and could well do so for a substantial future period.

The situation today has not changed fundamentally from that in late 1968. Penn Central has had insufficient time, in view of the magnitude of the business, the difficulty of the problems and the early introduction of the New Haven operations into the system, to solve the operating problems created by the merger. So far as the market price is concerned, the start-up difficulties have been highly publicized; the drain from the New Haven passenger deficits has not been alleviated by long-awaited aid from public authorities in New York and Connecticut; the deficits from Penn Central's own passenger operations continue; and, indeed, some state subsidies previously granted the New Haven have been terminated. It is little wonder that a stock with a cyclical history is experiencing a "low."

The Three-Judge Court below properly summarized the situation when it said:

> "Spot fluctuations are therefore not decisive, especially when, as here, there are reasonable explanations for them, such as the unanticipated difficulties in working out the operating details of the merger and the prospect of PC's having to shoulder NH losses at an earlier date and in larger amounts than had been anticipated."*

In addition, Penn Central has been adversely affected by factors of a more general nature, such as inflationary costs not yet met by freight rate increases, higher interest charges, and the slowdown in the economy, particularly in steel and automobiles. The Penn Central market price also reflects the substantial general decline in the stock market, particularly in issues ~~liable~~ vulnerable to cyclical change.

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* 305 F. Supp. at 1064, App. 430a.

D. *Analysis of the underwriting formula.*

The fundamental obligation of Penn Central under the underwriting formula is to pay in cash in February, 1978, the amount, if any, by which the actual market price of the Penn Central shares (based on a 30-day market average) is less than the $87.50 valuation, multiplied by the figure of 956,576 shares.* Thus, if the 30-day market average preceding February 1, 1978, is $77.50, Penn Central would be obligated to pay to the New Haven Estate $10 per share in cash, or the sum of $9,565,760.

The formula squarely meets the basic complaint of the bondholders below, which was that they had no assurance they would receive the differential between 63⅜ per share, the inclusion date price, and 87½ per share—the inherent value as determined by the Commission. The formula leaves the New Haven bondholders in a position to reap "upside" gain if the Penn Central stock should rise above $87.50 in value.

The underwriting formula not only fulfills what the bondholders sought, but grants a benefit they did not seek. This potential benefit, in the event predictions as to the future of the Penn Central stock value turn out to be wrong, lies in the "downside" guaranty.

More specifically, the bondholders have heretofore in this proceeding conceded that any decline in market value of the Penn Central stock after the inclusion date would be

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* Consisting of the 950,116 shares issued at the December 31, 1968 closing, plus the additional 6,460 shares issued pursuant to the Commission's Fifth Supplemental Report and accompanying order.

at their risk and their loss.* *But the result of the underwriting formula is to provide a seven-year post-inclusion guaranty against declines in the market price which still prevail in January of 1978.***

This "downside" guaranty has great potential value to the bondholders. If they had to pay for such an eight-year bond against loss (which, as a practical matter, would probably not be obtainable) it would cost the bondholders millions of dollars. The effect of the "downside" guaranty is to give the bondholders all the advantages of equity ownership with none of the risks. Clearly this aspect of the underwriting formula brings a major new element into the package of consideration received by the New Haven Estate, as we discuss further below.

The New Haven bondholders, now accepting the underwriting formula and the $87.50 valuation it supplements, argue that the New Haven Estate should receive interest on the difference between a past market price for the Penn Central Stock and $87.50 per share. The bondholders use different dates for the past market price of the Penn Central stock: the Committee uses December 31, 1966, while Manu-

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* For example, in its opening brief, dated January 17, 1969, addressed to the reviewing courts below (R. Doc. #8), the Committee stated (p. 63):

> "After the transfer, of course, the shares are held by the New Haven at its own risk and market fluctuations subsequent to January 1, 1969 do not affect the valuation questions in this case."

See also Gruss reply brief (p. 19), dated March 14, 1969 (R. Doc. #62):

> "[O]nce the stock was issued to the New Haven Trustees the State must take the risk of loss along with the possibility of gain."

** For example, if the stock market should remain at its currently depressed state and, as a consequence Penn Central stock in 1978 should be at a price of, say, $30 per share, Penn Central would be obligated under the formula to pay $55 million in cash (with a present value of $32 million on the inclusion date) as against the $23 million deficiency asserted below by the bondholders when they were prepared to accept the risk of the post-inclusion declines in the Penn Central stock's market price.

facturers uses, variously, December 10, 1969 and June 18, 1969. The market prices for these dates (average of high and low) were, respectively, 52⅜, 28 15/16 and 49½.* The bondholders do not limit their claim for interest to any cash which might ultimately be paid—their claim applies equally to appreciation in the Penn Central stock up to $87.50.

This claim is unjustified for a variety of reasons.

In the first place, it is wholly inconsistent with the premise of continued ownership of the Penn Central stock by the New Haven investment company. Assuming that expectations of growth in the value of the Penn Central stock prove out, there can have been no loss of the use of capital during the eight-year period—for the expectancy of the bondholders was simply that the Penn Central shares would be held for the life of the investment company.

Second, the interest claim has no legal foundation, since no fixed debt is due or ever has been due—as is evidenced by the difficulty the bondholders have in finding a date to begin the running of interest. If, on the other hand, the claim is based on equities, the underwriting formula itself, guaranteeing the gain, is a bonus for the bondholders which fully meets any appeal to fairness. The original $87.50 valuation made by the Commission was based on substantial evidence and was made in accordance with legal standards. It was well within the discretion of the Commission and the reviewing courts to conclude that the

* Committee, p. 101; Mfrs., p. 67. The Committee brief (p. 102) calls for "monthly interest at ½% above the prevailing prime rate on the difference between the value of the shares at December 31, 1966 and the date when the market establishes that shares could be sold to realize $83.1 net after expenses of sale . . ." Manufacturers (p. 68) frames its request in terms of a present payment equal to the excess of $83.1 million over the sum of the "market value" of the stock (Manufacturers uses a December 11, 1969 price of 28 15/16, or $27.5 million in the aggregate) and "the discounted value of the underwriting." Manufacturers uses $32.3 million as the present value of the underwriting and emerges with a figure of $23.3 million as its claim.

Estate, which had sought an equity position from the outset of the inclusion negotiations, could expect no more.

Third, nearly two-thirds of the claim of $23.3 million which Manufacturers has constructed as "interest" on the overall guaranty is allocable solely to the "downside" aspect of the guaranty. That is, the bondholders build their claim for interest largely on the post-inclusion price drop from 63⅜ to 28 15/16, or on the wholly unexpected assurance they will bear none of the risks of equity ownership.*

The claim for interest based on the difference between 63⅜ and 87½—which has no merit for the reasons already cited—is in any event more than offset by the value of the "downside" protection given the bondholders. The "downside" aspect of the guaranty had a value as of December 31, 1968 (viewed retroactively), and has a value today, which is clearly very substantial. As indicated in the footnote to this page, if one applies the reasoning and the figures of Manufacturers, one would conclude that the present worth of the "downside" portion of the guaranty is $18.1 million. While the post-inclusion price drop in the Penn Central stock is undoubtedly temporary, a covenant to

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* Manufacturers asserts, on the basis of Penn Central market prices on December 10, 1969, that the present value of the entire underwriting formula is $32,328,000 (the difference between the figures of $59,822,000 and $27,494,000 which appear on page 67 of the Manufacturers brief). However, this $32,328,000 stated value of the guaranty has two components, if it is analyzed from the standpoint of the original bondholder position that the stock should have been valued at the 63⅜ inclusion date price. The "upside" portion of the guaranty, applicable to the difference between 63⅜ and 87½, would have a present worth of about $14.2 million, under Manufacturers' calculations. The remainder of the guaranty, applicable to the difference between 28-15/16 and 63⅜, is attributable solely to the post-inclusion price drop. Thus, under Manufacturers' calculations, the present worth of the "downside" aspect of the guaranty is about $18.1 million. If their interest claim of $23.3 million is similarly apportioned (*i.e.*, in the ratio of $14.2 million and $18.1 million), then about $8.7 million of their interest claim is allocable to the "upside" and $14.6 million of the interest claim is allocable to the "downside" aspect of the guaranty.

underwrite another person's losses if the decline persists is obviously a promise of great value. Here Penn Central has been required to give such a covenant. Even if one has complete confidence in the future of Penn Central, the risks of depression and other events beyond Penn Central's control always exist. This added element of consideration far outweighs any claim for interest the bondholders can make.

In conclusion, it should be observed that it did not occur to either the Reorganization Court, which initially devised the underwriting formula, or to the Three-Judge Court which adopted it, that it would be appropriate or fair to add the interest provision that the bondholders now seek. Both courts considered the formula carefully, and must be assumed to have considered its impact on Penn Central as well as its great benefits to the New Haven. The bondholders did not raise this matter with the Commission prior to the issuance of its Fifth Supplemental Report or thereafter. Nor did the bondholders include an interest provision in the proposed orders they submitted to the Reorganization Court and the Three-Judge Court in the course of the settlement of the orders of those courts. We submit that the bondholders should not now be permitted to raise this objection in this Court.

The underwriting formula already gives the bondholders far more than equity requires, and the award of an additional advantage would be wholly unfair and unjustified.*

The bondholders purport to find still other defects in the underwriting formula. For example, Manufacturers (p. 68) calls for a 90-day test of market maintenance rather than 5 days, in order for the underwriting to be discharged. But the Courts below were obviously satisfied that the five-

* Not the least of the equitable considerations weighing against the bondholders is the fact that Penn Central has nothing comparable to the guaranty in so far as asset values are concerned, even though the true value of the New Haven properties is a matter involving a very substantial element of guesswork.

day test was a sufficient indication of value. Moreover, the bondholders' claim, if granted, would require Penn Central to guarantee a far higher value than $87.50. If the test is such that only one quotation below $87.50 in a 90-day period would vitiate the fulfillment of the test, then normal market fluctuations would require that the underwriting be of an *average* price well in excess of $87.50.

Another of the alleged defects is the absence of security for the Penn Central guaranty.* But there was no security for the position of the New Haven Estate as a Penn Central stockholder, and no priority whatsoever in the event of insolvency of Penn Central during the life of the investment company. In fact, the general creditor position of the Estate, with a claim of $87.50 per share, would be a dramatic elevation in the priority of the bondholders as compared with their position without the guaranty.

Two other defects are alleged only by Chase (pp. 94-5). Chase claims there are two "outs" from the underwriting formula: (1) in the "five-day" test (evidencing attainment of the $87.50 valuation), and (2) Penn Central's right to anticipate the underwriting obligation by paying deficiencies in value on designated blocks of stock prior to 1978. Obviously neither of these two provisions is a way of escaping an obligation, but rather they are alternative forms of *satisfaction* of the obligation imposed by the underwriting formula.

Chase's second claim is that the New Haven investment company directors should be *required* by decree to hold the Penn Central shares for the entire life of the investment company "in order that the New Haven have the opportunity to realize substantially more than $87.50 per share." Such a proposed restraint has no bearing on stock value and should be addressed to the Commission in its consideration of Step Two (the distributive provisions) of the reorganization plan.

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* Mfrs., p. 68; Committee, p. 99, 101-2.

II. This Court should affirm the unanimous finding of the Commission, the Special Master, the Reorganization Court and the Three-Judge Court that "free use" of Grand Central Terminal is of no value to the New Haven.

In claiming that Penn Central "received a windfall" of $70 million when it obtained the New Haven's right to "free use" of the Terminal, the bondholders are rearguing points which uniformly have been rejected below. The Commission, the Special Master appointed by the Reorganization Court,* the Reorganization Court, and a unanimous Three-Judge Court all agreed that "free use" of Grand Central Terminal ("G.C.T.") has no value to the New Haven.

A. *"Free Use" of the Terminal has no liquidation value to the New Haven.*

Under the hypothesis of actual liquidation, upon which the New Haven has been valued, the operation of the railroad is assumed to have ceased and its tracks are assumed to have been dismantled. With the tracks along the New Haven's right-of-way torn up, "free use" of the Terminal can be of no value to the New Haven (or anyone else). Where the valuation standard is *liquidation,* and not *going concern,* there is no room for assignment of value to contract or other rights which are pertinent solely to the operation of the very railroad which is assumed (by hypothesis) to have been scrapped.**

To the extent that the bondholders are arguing that "free use" has value in liquidation because the States of Connecticut and New York (the only conceivable purchasers) would purchase segments of the New Haven's pas-

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* See footnote 2, page 8 above.

** The Commission, the Reorganization Court and the Three-Judge Court have properly rejected the notion that "going concern" value can be added to liquidation value. 289 F. Supp. at 435, App. 347a; see 289 F. Supp. at 461-62, App. 250-51a. The bondholders' contrary arguments are answered in Point III below.

senger service in place, the answer is that the States have made it clear that they would pay no more than scrap or salvage value for the New Haven, and would pay nothing for "free use".* As the Three-Judge Court stated: "what is the 'salvage value' of property that cannot be sold to anyone else and is of no value in the owner's hands."**

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* See subpoint C below. The same liquidation hypothesis would also have been used as a test for valuation if the States had stepped in during the course of a New Haven abandonment proceeding. The States would have been the only conceivable purchasers of the New Haven in an abandonment context (Penn Central obviously would not bid for the deficit line) and, as the Commission and reviewing courts have properly found, the States would be held to no higher a price than "salvage value" (*i.e.*, without payment for "free use") should they take the New Haven under a certificate of abandonment. 305 F. Supp. at 1060, App. 420a; see 304 F. Supp. at 806, App. 294a; 334 I.C.C. at 32, App. 119a.

Chase's argument (p. 77) that the New Haven Estate could have assigned its interest in "free use" by "operation of law" is without merit because, as indicated above, there has never been a conceivable "assignee" willing to pay for "free use", and, as the reviewing courts recognized, the non-assignment clause found in Section 6 of the 1907 Terminal Agreement may well preclude such an assignment. (See discussion of this last point in R. Doc. #28, pp. 67-68.)

** 305 F. Supp. at 1060, App. 420a. Manufacturers asserts (p. 62) that, on a New Haven liquidation, Terminal expenses would decrease and excess income would thereby increase. This assertion is wholly unsupported by the record. The record shows that most Terminal expenses would be unaffected by a New Haven liquidation. Moreover, the evidence shows that Terminal expenses will rise by at least $180,000 a year. (Spec. M. Transcript, pp. 1120-29.) Such an increase—only in small part accounted for by the Commission in its valuation (see Point VI below)—would offset the saving in expense, if any, which could be accomplished because of the cessation of the New Haven's service. The Three-Judge Court took note of this fact; it also noted that concession income and other revenues now derived from the Terminal itself (an average of $4,222,379 per year) would decrease if the New Haven were liquidated. 305 F. Supp. 1060, App. 420a; see 304 F. Supp. 806, App. 294a. It is worth noting that the bondholders had four opportunities to present evidence as to decreased expenses (*i.e.*, twice before the Commission and twice before the Special Master) and failed to do so.

B. *There is no substance to the bondholders' claim that the New Haven should receive G.C.T. income unburdened by a deduction for Terminal expenses.*

The bondholders claim that the Commission and the reviewing courts, by valuing the New Haven's right to free use "on the basis of a hypothetical liquidation", effected a "forfeiture of all these rights" and thus deprived the New Haven of the equivalent of $70 million.* The bondholders' argument is that the flow of income from the G.C.T. properties,** which according to the basic 1907 Terminal Agreement, as supplemented in 1913, between the railroads must be used to pay Terminal expenses,*** should now be viewed as "unhinged" from such expenses and paid over to the bondholders. Of course, acceptance of this argument would leave Penn Central with 100% of the Terminal's expenses but with only a portion of the G.C.T. income dedicated thereto.

But no issue in this proceeding has been more thoroughly reviewed—nor more unanimously resolved against the

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* Committee, p. 130. The $70 million represents the alleged capitalized value of the part of the G.C.T. income flow which has been dedicated to payment of the New Haven's share of the Terminal expenses.

** The G.C.T. properties were "acquired by the New York Central in connection with the construction of Grand Central Terminal . . . and the tracks leading to it." 289 F. Supp. at 428, App. 333-334a.

*** Section 14 of the 1907 Terminal Agreement reads as follows:

> "and all such rentals or other compensation so received, and not belonging exclusively [by reason of agreements between the railroads not relevant here] to either Company, shall be *credited to the fixed charges or to the cost of maintenance and operation of the said Railroad Terminal, as the same may be applicable.*" (App. 165c; emphasis added.)

bondholders—than the claim that the New Haven should receive G.C.T. income unburdened by a deduction to cover Terminal expenses. The Three-Judge Court, after a painstaking examination of the basic agreements and of all other relevant factors, held:

> "It is scarcely conceivable that the Central would have agreed that NH, by picking up an option to share in the cost of building hotels or office buildings being constructed for the primary purpose of reducing the heavy expense of operating the Terminal, could quit at any time, take its share of the rentals and leave the Central burdened with the total expense of operating the Terminal, which would not be reduced anything like commensurately by NH's cessation of operations. Whereas only the clearest language would support such a construction, §14 [of the 1907 Terminal Agreement] looks quite the other way." 289 F. Supp. at 431, App. 339a.

The Special Master, looking at the same agreements, said the "construction which clearly should . . . be placed upon these agreements" (App. 278c) is as follows:

> "Both parties, as has been seen, committed themselves to pouring these revenues from the entire Grand Central complex into the Terminal Account under paragraph 14 of the Agreement of 1907. . . . Those revenues were pledged to that purpose regardless of whether New Haven utilized one per cent or fifty per cent of the Terminal's passenger facilities, or whether it used any of those facilities at all. It was not contemplated that if either railroad discontinued passenger trains into Grand Central the other would be saddled with the entire expense of a terminal larger than either railroad needed without being credited with these entire revenues from the Grand Central Terminal properties to the extent that they were required to meet expenditures. . . ." (App. 277c.)

The Reorganization Court agreed with, and "adopted", the Special Master's conclusion.*

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* 289 F. Supp. at 463, App. 252a.

In short, the bondholders' claim has been unanimously rejected by the Commission, the Special Master and the two reviewing courts. The express language of the relevant agreements, sixty years of uniform application of the terms of such agreements, and the obvious business purpose of the railroads involved, all point to the manifest correctness of the holdings below.

Chase adds its own gloss to the bondholders' claim that G.C.T. income should be "unhinged" from expenses and awarded directly to the New Haven. Chase argues that the 1907 Terminal Agreement, as supplemented in 1913, which dedicated G.C.T. income, was "wiped out" by the transfer of the New Haven's interest under the Agreement to Penn Central on December 31, 1968, that Penn Central now has G.C.T. income "free and clear of any restriction" as to Terminal expenses, and that the New Haven should, therefore, receive $70 million in exchange for what it has transferred. (Chase, p. 74.) This argument is both self-defeating in legal terms and wholly fallacious in economic terms.

The notion that the basic 1907 Terminal Agreement, as supplemented in 1913, has been "wiped out" is completely inconsistent with the established fact that the New Haven's limited interest in the G.C.T. properties derives solely from the Agreement.* If the Agreement were no

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* See 289 F. Supp. 428-33, App. 333-343a; *New York Central R.R.* v. *New York, N.H. & H. R.R.*, 24 Misc. 2d 414, 208 N.Y.S.2d 605 (Sup. Ct. 1960) *aff'd*, 13 App. Div. 2d 309, 216 N.Y.S.2d 928 (1st Dep't 1961), *aff'd without opinion*, 11 N.Y.2d 1077, 184 N.E.2d 194, 230 N.Y.S.2d 226 (1962) (the "Biltmore" case). In that case, the New York Supreme Court said that the New Haven has "contractual rights to the Terminal area, although they 'fall short of ownership' and do not grant 'full possession of the physical thing' ". 24 Misc. 2d at 428, 208 N.Y.S.2d at 614. Similarly, the Appellate Division said that the Central was "owner of the fee" and that the New Haven's rights "for good consideration, were carved out of the fee." 13 App. Div. 2d at 318, 216 N.Y.S.2d at 936. In this regard, the decisions of the New York Courts are in accord with this Court's opinion in *ICC* v. *New York, N.H. & H. R.R.*, 287 U.S. 178 (1932).

longer in existence after December 31, 1968, then all claims of the New Haven to the G.C.T. properties were also "wiped out"—and/or transferred—as of that date.

As to the economic realities, Penn Central assumed the burden of all the Terminal expenses after December 31, 1968. Thus, the theoretical right to all of the G.C.T. income constituted no benefit whatsoever to Penn Central. If Penn Central uses G.C.T. income (which has heretofore been used to pay Terminal expenses) for "other purposes" (as asserted by Chase), it would merely be paying the Terminal expenses out of one pocket rather than another; Penn Central would still have to maintain the Terminal and pay all expenses related thereto.

C. *The state authorities will pay nothing for free use and such use is of no benefit to Penn Central.*

The bondholders continue to argue that Penn Central will receive (or has received) a "windfall" for "free use" from the New York and Connecticut State authorities. But this is simply untrue. The Commission, the Reorganization Court and the Three-Judge Court all agreed that the States, in taking over the deficit-ridden New Haven passenger operation, would have more than ample bargaining power to put themselves in the New Haven's shoes and thereby to obtain "free use."* The Three-Judge Court, for example, said:

> "Indeed, the State, if it wished to continue using GCT, might well be able, either through its own bargaining position or the power of the ICC, to obtain a transfer of this right without making any payments to NH that would increase the 'liquidation value' of this unique type of asset above the sum that could be realized if the State were not a buyer. 289 F. Supp. at 431. While we do not disagree with the bondholders' position that a state must pay the

* 305 F. Supp. at 1060, App. 419-20a; 304 F. Supp., at 806, App. 294a; 334 I.C.C. at 32, App. 119a.

> salvage value of property of a defunct railroad that it wishes to acquire, what is the 'salvage value' of property that cannot be sold to anyone else and is of no value in the owner's hands?'"*

Indeed, as of this date, the States have signed a Memorandum of Intent with Penn Central whereby they will, *in fact*, obtain "free use". In its brief, Manufacturers, referring to Penn Central's Memorandum of Intent with the State authorities, said:

> "We understand that as part of this agreement, the Commuter Authority will lease from Penn Central the tracks between Woodlawn, N. Y. and the Terminal and partial use of the Terminal itself under terms whereby it will pay $2.9 million per year. New York Times, November 26, 1969, pp. 1, 32." (Mfrs., p. 59 fn.)

But the $2.9 million payment referred to by Manufacturers is merely the equivalent of the separate annual "toll" payment (not connected with or covered by G.C.T. income) that the New Haven made, under a separate agreement, for use of the right-of-way between the Terminal

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* 305 F. Supp. at 1060, App. 419-20a. Similarly, the Reorganization Court held:

> "The Special Master and the Three-Judge Court concluded there was no value in the interest, principally because it is not the kind of interest that would survive the liquidation; nor, if it did, could it be assigned. Moreover, there was no evidence that the expenses of maintaining the Terminal would be any less. And the idea that the State of New York, or an interstate authority might pay, directly or indirectly, some consideration for availing itself of that use is highly speculative in view of the bargaining positions of the states and the disposition of the I.C.C. to require Penn Central to furnish such access free of charge to a state or public authority which assumed the commuter service, as a condition of Penn Central's getting rid of that much of the losing and burdensome passenger service. While mitigation of a burden may in some circumstances furnish a consideration, it is not a measurable one for the purpose of this issue in the case." 304 F. Supp. at 806, App. 294a.

and Woodlawn, New York, prior to the inclusion*; *no payment* is provided for use of the Terminal itself. Indeed, the *New York Times* article, cited by Manufacturers, makes this quite clear:

> "The state-run rail service *will use Grand Central Terminal without charge,* but will pay $2.9 million annually to the railroad for use of the right-of-way between the terminal and Woodlawn." (*Id.* at 32; emphasis added.)

Finally, the bondholders' attempt to shift the focus of this proceeding so as to look at what Penn Central is *receiving,* as opposed to the value of "free use" to the New Haven in liquidation, should be rejected. After the inclusion, Penn Central obviously gained no advantage from the income dedicated to Terminal expenses, since it had to pay all of the Terminal's expenses.** Moreover, the record shows—and the Commission found—that such expenses will increase by, at least, $180,000 a year in the future.*** Prior to December 31, 1968, Penn Central already had a right to "free use" of the Terminal for its trains. No matter what happened to the New Haven, Penn Central would have continued to have this right and having more of the same is no advantage.

When all is said and done, the bondholders' claim to a $70 million payment for what Penn Central "receives" amounts to a demand that this Court not only require Penn Central to take over the deficit-ridden New Haven† but that it require Penn Central to increase greatly the deficits by giving to the bondholders a portion of the G.C.T.

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* See NHI-71, p. 16, R. Doc. #120; T. 24631.

** See discussion, page 103 above.

*** 334 I.C.C. at 34, App. 120a; Spec. M Transcript, pp. 1120-29; see footnote 2, page 99 above.

† Valuing the New Haven as a "going concern" would, of course, result in a negative valuation as opposed to the almost $150 million that Penn Central is being required to pay for it.

income dedicated to the payment of Terminal expenses.* The bondholders might as easily—and no more improperly—have claimed that Penn Central should give them the New Haven's passenger fares or freight revenues while it runs, and absorbs the deficits of, the New Haven's trains.**

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* On remand, the Commission properly concluded:

"The bondholders' 'free use' argument is in a real sense no more than an attempt to revive their argument, rejected by us and the courts, that NH is entitled to one-half interest in the terminal income *before* terminal expenses." 334 I.C.C. at 32 n.11, App. 119a.

** We do not deal here in detail with the bondholder allegations as to error in the computation of the G.C.T. income above Terminal expenses (the "excess income"). See Committee, p. 122 fn. 2. Suffice it to say that in its Remand Report the Commission carefully examined the evidence and awarded the New Haven Estate the full value of its claimed 50% interest in the excess income. 334 I.C.C. at 30-39, App. 117-126a. The Commission's finding as to excess income was extensively litigated below; the Reorganization Court and a unanimous Three-Judge Court affirmed the Commission's valuation. 304 F. Supp. at 806, App. 294-295a; 305 F. Supp. at 1060, App. 420-422a. A full statement of Penn Central's position on this point is found in R. Doc. #28, pp. 75-107.

Similarly, the Committee's claim (p. 130) that the New Haven Estate should have been awarded pre-judgment interest on G.C.T. excess income for the years 1964 through 1968 should be rejected. The Commission and reviewing courts acknowledged that the New Haven's claimed right to a share in excess income had not been established with "the same finality as an adjudication by the New York State courts would do." 289 F. Supp. at 463, App. 253a. Nevertheless, they awarded the New Haven the full value of a 50% share in the income. The Commission and reviewing courts were overly generous to the New Haven and well within their discretion in not providing pre-judgment interest on such income, which was not fixed or owing before the judgment date.

III. The bondholders are not entitled to a "going concern value" in addition to liquidation value for their deficit railroad.

The bondholders claim 10% of their own witness Shannon's inflated estimate of the New Haven's "going concern value", or $5.5 million. There is no merit to their claim even for the lesser figure. We are content to rest upon the rejections of this claim in the opinions of the Commission* and the Three-Judge Court,** adopted by the Reorganization Court.*** As the Commission said, adding "going concern value" to the liquidation value of a deficit railroad "contains an inherent contradiction." We will discuss only the bondholders' contention that the Commission and the Courts were bound by *In the Matter of Port Authority Trans-Hudson Corp.*, 20 N.Y.2d 457, 231 N.E.2d 734, 285 N.Y.S.2d 24 (1967), *cert. denied*, 390 U.S. 1002 (1968) (*"PATH"*), to ignore the inconsistency in valuation standards.

Since *PATH* involved the taking by the State of New York in condemnation of the Hudson tubes for public transit use, it has no direct application to the instant case, which involves no element of a governmental taking. The New Haven Trustees made application for and fought for inclusion, with the tacit concurrence of the bondholders. The bondholders made no objection to the Reorganization Court's order of December 24, 1968† transferring their property (including, of course, the property situated in New York State) to Penn Central, and took no appeal therefrom. The transfer was, therefore, wholly voluntary on their part, and their consent was given with awareness that the Reorganization Court, as well as the Commission and the Three-Judge Court, had theretofore held that the

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* 331 I.C.C. at 686-87, App. 44-45a.

** 289 F. Supp. at 435, App. 347-49a.

*** 289 F. Supp. at 454-55, App. 239-40a.

† App. 269-76a; see App. 393a.

New Haven possessed no going concern value over and above its liquidation value.

The bondholder reliance on *PATH* is also misplaced because this proceeding, involving an interstate railroad running through four states, is governed by two federal statutes, Section 77 of the Bankruptcy Act and Section 5(2) of the Interstate Commerce Act. Federal law governs the fundamentals of the transaction, including the issues of valuation methods and fairness.* *PATH* has no force in this proceeding, for this Court has unequivocally declared the supremacy of federal law renders the determinations of the Interstate Commerce Commission controlling within the scope of its regulatory powers. *Schwabacher* v. *United States*, 334 U.S. 182, 189-202 (1948).**

Moreover, adoption of the valuation standard announced in *PATH* cannot benefit the bondholders in this proceeding. *PATH* involved a set of facts which the Court of Appeals referred to as "*sui generis* and one which requires an approach different from that generally followed."*** The trial court had awarded $55 million for the Hudson tubes, $30 million of which was allocated to the sub-Hudson tunnel property. On appeal, the Appellate Division, adopting scrap value as its criterion because of the absence of com-

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* Even if, on the liquidation assumption, the New Haven had sought an abandonment certificate pursuant to Section 1(18) of the Interstate Commerce Act, as the Three-Judge Court noted, the Commission could have conditioned an abandonment certificate upon the New Haven's agreement to sell its assets at their scrap value to a purchaser who would continue to operate the properties as a railroad. 289 F. Supp. at 435, App. 348-49a. In that event, again federal law would have governed the transaction.

** The federal courts, dealing with condemnations by the federal government, have, like the Commission here, long perceived the the impropriety of awarding going concern value in the valuation of an unprofitable company. *Kimball Laundry Co.* v. *United States*, 338 U.S. 1, 9 (1948) (dictum); *United States* v. *Jacksonville*, 257 F.2d 330, 334 (8th Cir. 1958); *United States* v. *Boston C.C.&N.Y. Canal Co.*, 271 Fed. 877, 896-97 (1st Cir. 1921).

*** 20 N.Y.2d at 472, 231 N.E.2d at 731.

mercial purchasers for the property, reduced the $55 million award to $3.5 million, allocating "virtually nothing" to the tunnel property.*

Reasoning that it would be "manifestly unjust" to award virtually nothing for the tunnel property "which would cost in excess of $400,000,000 to reproduce and require an expenditure of only $88,000 to put in perfect working order . . ."**, the Court of Appeals reinstated the trial court's $30 million award for the tunnel property and remanded to the trial court for further consideration. The Court concluded that this $30 million award of the trial court was "fair and just" because the property had "a usefulness created by the owner himself through the expenditure of large sums of money and by the continued operation of the property for the very purpose for which [the condemnor was] . . . acquiring the property."***

In essence, therefore, the Court of Appeals in *PATH* concluded that an award of some going concern value for the tunnel property (there computed on the basis of original cost less depreciation) was fair in the total absence of a scrap value for that property.† By contrast, in the instant case, the bondholders have assiduously advocated a liquidation value standard because any consistent application of a going concern standard to the New Haven properties would result in a large negative figure. Moreover, they have gone to great lengths to argue that the Commission and this Court could not consider what is "fair and just" on the ground that the Constitution mandates a higher figure, to-wit, liquidation value. Therefore, when they attempt to impose a "going concern value" over and

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* 20 N.Y.2d at 467, 231 N.Y.S.2d 737.

** *Id.*

*** 20 N.Y.2d at 468, 231 N.E.2d at 738.

† Indeed, it would appear that the scrap value for the tunnel property was a negative figure, due to the cost of sealing the tunnel. 20 N.Y.2d at 467 n.2, 231 N.E.2d at 737 n.2.

above the result achieved by the liquidation value standard, they pervert the principle of fairness and justice adopted by the Court of Appeals in *PATH*.*

IV. The Committee's claim of constitutional infirmity in the transfer of New Haven investments is meritless and barred by *res judicata*.

The Committee brief (pp. 152-53) asserts that the Commission violated the Fifth Amendment by requiring the transfer to Penn Central of the New Haven's investments in Railway Express Agency, Inc. and in the New York Connecting Railroad Company at no cost to Penn Central because the investments were valueless. This contention has no substance.

Presumably, the Committee's constitutional theory is that there was a "taking" of these investments without compensation, notwithstanding that the investments were transferred as a result of voluntary efforts of the New Haven Trustees, with the full approval of the Reorganization Court under an order (App. 273-74a) not challenged or appealed by the bondholders. Clearly the bondholders are now barred by principles of *res judicata* from challeng-

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* The bondholders also purport to place reliance upon the two opinions of the New York Court of Appeals in *Matter of the City of New York (Fifth Avenue Coach Lines)*, 18 N.Y.2d 212, 219 N.E.2d 410, 23 N.Y.S.2d 52 (1966) and 22 N.Y.2d 613, 241 N.E.2d 717, 294 N.Y.S.2d 502 (1968). However, the bus company condemned by the City of New York in that case lacked earnings because of action of the City in denying the company the right to charge fares at which it could make a profit. The Court of Appeals considered an award of going concern value appropriate in that case because, as it explained in the *PATH* case:

> "We felt it would not conform to traditional standards of equity and justice to permit the city to break the company financially and then pick up the pieces at a highly depreciated rate." 20 N.Y.2d at 470, 231 N.E.2d at 739.

ing the *transfer* of these investments to Penn Central.* Only their right to contest the *valuation* was preserved, and they set forth no basis to upset it.

The Commission valued both investments on the basis of testimony of the Trustees' witness Gordon. The Railway Express investment consisted of 91,344 shares of common stock and a $1,272,284 face value 5% note.** Gordon valued the note at face value, assigning no value to the stock.*** With respect to the New York Connecting, Gordon's estimate was based on the following analysis:

> "New York Connecting's funded debt totals $17,995,000 compared with depreciated book value of the property of $20,464,357. Since approximately 14 million dollars of this amount represents investment in bridges, engineering, etc. there remains slightly less than six and a half million dollars of property which would have some salvageable value. Obviously the stock has no value.†

Clearly, in the absence of contrary evidence, the Commission was reasonable in adopting the Gordon evidence.††

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* *Stoll* v. *Gottlieb*, 305 U.S. 165 (1938); *Chicot County Drainage Dist.* v. *Baxter State Bank*, 308 U.S. 371 (1940).

** NHI-30, p. 15; App. 273-74a.

*** NHI-42, pp. 8-9; App. 49c.

† *Id.*

†† Moreover, the Committee's characterizations of these investments as "not railroad operating properties but investments" is inaccurate. The New York Connecting shares constitute half ownership in the New York Connecting Railroad, which maintains the Hell Gate Rail Bridge joining the New Haven freight line with Penn Central tracks on Long Island. (App. 333c; T. 29708-09.) The New York Connecting shares constitute, therefore, half ownership of an operating segment of a combined Penn Central-New Haven system. At the time of the transfer, Railway Express was also a rail-affiliated company, owned solely by the railroads.

V. The Commission's conclusion that to require Penn Central to assume more than $5 million in pre-inclusion 1968 New Haven losses would be inequitable was a proper exercise of its judgment and discretion.

Acknowledging that it knew of no legal requirement that would compel Penn Central to absorb pre-inclusion losses of the New Haven, the Commission on fairness grounds required Penn Central to assume $5 million of such losses incurred between the date of the Penn Central merger (February 1, 1968), and the inclusion date (December 31, 1968.)*

The bondholders contend that the Commission's determination is not fair or equitable, involves an invasion of their constitutional rights and is contrary to the intent of this Court.** None of these points has merit.

The Commission's initial three-year loss-sharing formula*** was not in fact the product of a fairness standard so much as an essential condition of survival. Penn Central was not responsible for the delay in inclusion; yet because of the New Haven's cash problems its ability to survive the waiting period had been pointedly questioned. This justification for imposition of pre-inclusion losses on Penn Central evaporated when, in the Remand Report, the Commission required inclusion on December 31, 1968. By that action, the Commission in effect revised its earlier three-year formula by imposing 100% of the New Haven losses on Penn Central in the second and third years. The Commission, nevertheless, imposed a substantial portion of the

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* 331 I.C.C. at 704, 715-16, 334 I.C.C. at 71-72, App. 62a, 73-74a, 158-61a.

** See *e.g.*, Manufacturers brief, pp. 85-86.

*** 331 I.C.C. at 718, App. 76a.

first year's losses on Penn Central.* Fairness to the New Haven, we submit, required much less.

The bondholders' contention that the Constitution required Penn Central after its merger to assume all of the New Haven losses is contrary to the holding of the Reorganization Court, namely, that the point at which the New Haven was constitutionally entitled to cease operations was December 31, 1968.**

Finally, this Court has recognized that "the probable difficulties in reaching agreement for inclusion of the NH which will satisfy its bondholders . . .", rather than considerations of convenience to Penn Central, were responsible for the delay in inclusion of the New Haven after consummation of the Penn Central merger.***

The bondholders have maintained, with respect to other issues, that the Commission was bound by constitutional absolutes and to that extent was barred from considering the fairness of the inclusion transaction to Penn Central. Here, in an area where fairness is the sole criterion, they argue that the courts and not the Commission should make the determination. The Commission's determination was a proper exercise of its judgment and discretion in an area of responsibility assigned to it by Congress, and the bondholders have presented no legal basis for overturning it.

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* Based on the Commission's findings, Penn Central has been required to assume about 60% of the New Haven's losses as computed under the Commission's loss-sharing formula for the final eleven months of 1968. 334 I.C.C. at 73, App. 160a.

** 289 F. Supp. at 458-61, App. 244-49a.

*** 389 U.S. at 510; see *id* at 509-11.

VI. The Commission's ultimate finding that the inclusion terms are fair involves no gross error or unfairness.

The multiplicity and complexity of the particularized issues of fact and judgment that the Commission was required to resolve in determining the liquidation value of the New Haven make it appropriate at this point in the discussion to review the Commission's action as a whole. For the reasons that have been stated above, we submit that the Commission did not err in any of the specific respects now asserted by appellants. Beyond that we submit that an objective review of the entire record shows that the Commission's valuation of the New Haven's assets represents a careful, conscientious and reasoned consideration of all of the evidence, and that the Commission's ultimate determination involves no "gross error or unfairness." *Penn-Central Merger and N&W Inclusion Cases*, 389 U.S. 486, 524 (1968).

Certainly there is no warrant for the appellants' repeated suggestion that the Commission was moved by partiality for Penn Central, or that the Commission's concern for its public interest responsibilities led it to reduce arbitrarily the valuation of the New Haven below a realistic liquidation level. In a number of substantial respects we believe that the Commission erred by deciding issues in favor of the New Haven when a contrary decision was more than justified. The cumulative effect of these errors suggests that, at the very least, the Commission resolved doubtful questions in favor of the New Haven. In their total impact these errors increased the liquidation value of the New Haven substantially beyond any amount we believe it could, in fact, have obtained in an actual liquidation. Penn Central raised these points in the courts below. The Three-Judge Court, while adverting to some of these matters as supporting the fairness of the Commission's valuation, made no downward adjustments in that valua-

tion. Even though Penn Central, in the hope of avoiding further protracted proceedings before the Commission, did not appeal from the order of the Three-Judge Court, we submit that these determinations of the Commission are relevant in considering the fairness of its ultimate result. The more significant of these determinations are briefly discussed below.

A. Liquidation value findings overly generous to the bondholders.

1. Although the Commission recognized "the doubt" as to whether a proposed building over Grand Central Terminal in New York City would be constructed in view of the opposition of municipal authorities,* the Commission nevertheless awarded the Estate the full capitalized value of the estimated lease income from the proposed building ($8 million).** The Three-Judge Court recognized that Penn Central has "grievances" with respect to this aspect of the valuation,*** but did not remand this issue to the Commission for a reduction of its valuation.

2. In computing the New Haven's shares of future excess income from Grand Central Terminal, the Commission accepted the testimony of a Penn Central witness to the effect that Terminal expenses would increase $180,000 in each

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* 334 I.C.C. at 34, App. 121a. This doubt arises principally from the designation of Grand Central Terminal as a landmark under the New York City Landmarks Preservation Act, Chapter 8-A of the New York City Charter and Administrative Code. The record includes the order by the Landmarks Preservation Commission, which administers the statute, denying a "certificate of no exterior effect". Such a certificate would have constituted the approval by that Commission of construction of the building. (R-24, Schedule G.) At the remand hearing, a Penn Central witness acknowledged the possibility of applying to the Landmarks Commission for a "certificate of appropriateness" (T. 28910), and such an application was in fact made, but that application was also denied by the Landmarks Commission, by order dated August 26, 1969.

** 334 I.C.C. at 33-35, 39, App. 120-22a, 126a.

*** 305 F. Supp. at 1061, App. 421-22a.

year through 1975.* The Commission found that: "The carrier's projection of annual increased costs of $180,000 is reasonable."** However, in its computation, the Commission accounted for the increase in expenses for only one year, whereas its finding and the testimony it accepted required an increase in each year through 1975. The proper recalculation would reduce the value of the New Haven's share of excess income by $6.4 million.

3. In determining the liquidation value of the New Haven, the Commission assumed that complete liquidation would be accomplished in six years. It indulged in this assumption in the face of substantial evidence that a ten-year period would be required, and despite the fact that the witnesses who projected the six-year period admitted that their estimate was optimistic. See page 46 above. Even the Commission itself did not find that the liquidation would be complete in six years, but only that "the bulk of the liquidation" could be accomplished in that period.*** If the Commission had made a more realistic estimate of the length of the liquidation period, the liquidation value assigned to the New Haven assets would have been substantially decreased.

B. ***Understatement of liquidation expenses.***

1. In its Inclusion Report, the Commission, in accordance with the Trustees' study, deducted from the projected liquidation receipts $16.2 million in unpaid prebankruptcy New Haven real estate taxes. In the 1968 appeals, the reviewing courts held this deduction improper because the New Haven could not fairly be charged under the hypothetical liquidation assumption with taxes it was also going to bear in inclusion (the sale to Penn Central was to be free and clear of all such taxes).

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* Spec. M. Transcript, p. 1129.

** 334 I.C.C. at 33, App. 120a.

*** 331 I.C.C. at 663, App. 21a.

The Three-Judge Court* and later the Commission** indicated that, to the extent the New Haven might in the inclusion-reorganization transaction be able to compromise those taxes, it would be fair to treat the compromised amounts in the same manner as they had been treated in the Inclusion Report, *i.e.*, as liquidation expenses. No adjustment was made at that time since there was no definitive evidence before the Commission on remand as to the actual amount of any compromises.*** However, a substantial compromise of such taxes has just recently been approved by the Reorganization Court, involving abatement by Boston, Massachusetts of $3,216,738 of such taxes.† Accordingly, under the rulings of the Three-Judge Court and the Commission, the liquidation expenses were understated, and hence the New Haven's liquidation value overstated, by at least $3.2 million.

2. Along the same lines as the foregoing error, the Commission in its Inclusion Report, "deleted from liquidation expenses" $1,249,847 in postbankruptcy interest on unpaid prebankruptcy real estate taxes,†† although the Trustees' witness testified that in liquidation this interest would have to be paid.‡ The Commission's purported basis for doing so should have been its reason for *not* doing so, *i.e.*, it observed that *in reorganization* the Trustees proposed no payment of this interest.‡‡

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* 289 F. Supp. at 438, App. 353a.

** 334 I.C.C. at 41, App. 128a.

*** See *id.*

† Petition of the Trustee for Order No. 596, December 3, 1969; Order No. 596 granting said Petition, December 22, 1969; see 1969 Report of the Trustee to the Reorganization Court, February 27, 1970, pp. 8047-50.

†† 331 I.C.C. at 663, App. 21a.

‡ App. 61-62c; T. 23507.

‡‡ The Commission was correct that this interest would not be paid in reorganization, as the amended plan of reorganization so provides. 334 I.C.C. at 97, 113, App. 184a, 200a (Administration claims, Class D).

Thus, this $1.2 million in interest, like the compromised taxes, should have been treated as a liquidation expense.*

C. *Understatement of the consideration received by the Estate from Penn Central in the inclusion transaction.*

1. The Trustee anticipates very substantial tax benefits from inclusion which would have been unavailable in liquidation. These benefits should be credited as consideration received by the New Haven Estate in comparing the inclusion transaction with liquidation.

Pursuant to authority from the Reorganization Court, the Trustee has filed requests with the Internal Revenue Service for rulings that: (1) the New Haven's net basis for its assets transferred to Penn Central (*i.e.*, book value of $308.6 million) constitutes its tax basis for the Penn Central securities received at time of inclusion; and (2) that the approximately $60 million in net operating loss carryforwards which accrued in the five-year period prior to the sale to Penn Central are retained by the New Haven.** The use of book value of assets as the tax basis for the securities received would be beneficial to the New Haven in establishing a loss upon any sale of the Penn Central securities, and the carryforward benefit would be beneficial

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* We note also that the Three-Judge Court erred in failing to accept the Commission's finding in its Remand Report (334 I.C.C. at 41, App. 128a) that the proposed payment of such taxes under the reorganization plan in income notes rather than in cash effected a $1.6 million reduction in such taxes. The Three-Judge Court mistakenly believed there was no assurance that the holders of the tax liens would accept the income notes, 305 F. Supp. at 1062-63, App. 425-26a, but no state or locality appeared before the Reorganization Court to object to this procedure. The Reorganization Court has ruled that taxing authorities "are barred from now filing objections and claims for equitable treatment." Transcript of Hearing and Argument before Reorganization Court, March 31, 1969, p. 16.

** 1969 Report of the Trustee to the Reorganization Court, February 27, 1970, p. 8062; see Petition for Order No. 581, July 15, 1969 (Cert. Rec. #70).

because the prior years' losses could be offset against income of the reorganized New Haven Company.*

Because the bondholders initially believed these tax benefits would flow to Penn Central, they introduced testimony that the basis benefit would be substantial and that the carryforward benefit had a market value of at least 15% of the amount of the losses for the five-year period preceding inclusion, or $9 million (15% x $60 million).** The Commission should have, but did not, treat these tax benefits as consideration received by the Estate solely by virtue of inclusion.

2. Uncontradicted testimony of Trustee Kirk established that the New Haven benefited in the amount of at least $5 million from Penn Central's commitment in the Purchase Agreement, since implemented in the inclusion transaction, to assume New Haven's labor protection, pension and equipment obligations.*** There is no justification for the Commission's refusal to ascribe value to the New Haven from Penn Central's commitment, as the bondholders presented no evidence to dispute Trustee Kirk or to show that the Estate could free itself of these obligations at no cost to itself.

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* Transcript of Hearing before Reorganization Court on Petition for Order No. 581, July 15, 1969 (testimony of Trustee Smith).

** This testimony was given by former Commissioner of Internal Revenue Mortimer Caplin, who based the 15% upon "a rule of thumb among businessmen" in acquisition negotiations. (NHI-105; T. 25870, 25938.)

*** NHI-65, pp. 25-26. These items may, alternatively, be viewed as liquidation expenses not present in the inclusion transaction. With respect to labor protection and pension costs, for example, Trustee Kirk testified there would be an issue as to legal liability of the Estate on liquidation and that there would be value to the Estate in "not being required to litigate these questions, or replace personnel, or make *ad hoc* settlements with existing personnel." He assigned a value to the Estate of $2.5 million to this item and $2.5 million to the assumption of equipment obligations. On the side of *cost to Penn Central*, its commitments in respect of these items were found by the Commission to total $16.1 million. 334 I.C.C. at 65, App. 152a.

CONCLUSION

For the foregoing reasons, we respectfully submit that the decree of the Three-Judge Court should be affirmed and the order of the Reorganization Court should be reversed, vacated and remanded to that Court with instructions to modify its order to conform with the findings of the Commission in its Fourth Supplemental Report, as modified in its Fifth Supplemental Report, sustained by the Three-Judge Court in its decree.

Respectfully submitted,

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March 18, 1970.

APPENDIX A

Cross-Reference Table

The exhibits before the Commission at the initial inclusion hearings and on remand, the transcripts of those hearings and the transcripts of the hearings before the Special Master appointed by the Reorganization Court, can be found in the record on appeal to this Court from the Three-Judge Court as follows:

Commission Exhibit No.	R. Doc. #
NHI- 1 through NHI- 27	118
NHI- 28 through NHI- 58	119
NHI- 59 through NHI- 87	120
NHI- 88 through NHI- 94	121
NHI- 95 and NHI-96	122
NHI- 97 through NHI-115	123
NHI-116 through NHI-135	124
R-1 through R-27	50
R-28	51
R-29	50
R-30-33	51
R-34-46	50

Commission Transcript Pages	Date of Transcript	R. Doc. #
22469-22635A	1/16/67	108
22636-22733	1/17/67	108
22734-22845	1/18/67	108
22846-22975	1/19/67	108
22976-23071	1/20/67	109
23072-23219	1/23/67	109
23220-23347	1/24/67	109
23348-23468	1/25/67	109
23469-23588A	1/26/67	110
23580-23802A	1/27/67	110
23803-23940A	1/31/67	110

Commission Transcript Pages	Date of Transcript	R. Doc. #
23941-24083	2/ 1/67	111
24084-24217	2/ 2/67	111
24218-24303	2/ 3/67	111
24304-24416	2/ 6/67	111
24417-24496	2/ 7/67	112
24497-24536A	2/ 8/67	112
24537-24674	2/14/67	112
24675-24815	2/15/67	112
24816-24950A	2/16/67	113
24951-25051	2/17/67	113
25052-25179A	2/20/67	113
25180-25355	3/20/67	114
25356-25529	3/21/67	114
25530-25659A	3/22/67	114
25660-25823	3/23/67	114
25824-26016	3/27/67	115
26017-26171	3/28/67	115
26172-26334	3/29/67	115
26335-26480	5/ 3/67	116
26481-26622	5/ 4/67	116
26623-26773	5/ 5/67	116
26774-26915	5/ 8/67	116
26916-27182	5/ 9/67	117
27183-27253	5/11/67	117
27254-27470	5/12/67	117
28602-28790	10/ 7/68	47
28791-28976	10/ 8/68	47
28977-29243	10/ 9/68	48
29244-29482	10/10/68	48
29483-29652	10/11/68	49
29653-29893	10/14/68	49
29894-30119	10/15/68	49

Master's Hearing Transcript No.	Date of Transcript	R. Doc. #
1-162	5/ 2/68	52
162-407A	5/ 7/68	52
408-644	5/ 8/68	52
645-824	7/ 8/68	53
825-1012	7/ 9/68	53
1013-1228	7/10/68	53
1229-1426	7/11/68	54
1427-1632	7/12/68	54
1633-1770A	7/13/68	54

Summary of Legislative History of First Sentence of Final Paragraph of Section 77(e)

The pre-1933 Bankruptcy Act did not apply to railroad receiverships, which, prior to 1933, were conducted as proceedings in equity. The role of the Commission during that period was extremely limited and, in large measure, "after-the-fact" in that, under equity procedure, the Commission was not given an opportunity to review a plan until after the creditors and stockholders of the debtor had acted upon the plan.

In 1933 Section 77 of the Bankruptcy Act was proposed, in order to remedy

> "... the present expensive, protracted, confusing and inefficient administration of affairs of railroad companies engaged in interstate commerce in equity receiverships."*

The new Section 77 provided for hearings before the Commission as soon as the reorganization plan was filed, thereby markedly increasing the opportunity of the Commission to affect the development of the plan. As Justice Frankfurter said in *Palmer* v. *Massachusetts*, 308 U.S. 79 (1939):

> "Indeed, when, in the depth of the depression, legislation was deemed urgent to meet the grave crisis confronting the railroads, there was a strong sentiment in Congress to withdraw from the courts control over insolvent railroads and lodge it with the Interstate Commerce Commission. [Citations omitted.] Congress stopped short of this remedy. But the whole scheme of §77 leaves no doubt that Congress did not mean to grant to the district courts the same scope as to bankrupt roads that they may have in dealing with other bankrupt estates." 308 U.S. at 86-87.

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* H.R. Rep. No. 1897, 72d Cong., 2d Sess. 5 (1933).

By 1935 the brief experience with the version of Section 77 enacted in 1933 had demonstrated that it had not cured all of the defects of the prior reorganization procedure, including the delay and expense of railroad reorganizations. Accordingly, in 1935, extensive amendments to Section 77 were proposed, including the so-called "cram-down" provisions and certain valuation standards. These proposed amendments were contained in a bill submitted to the Judiciary Committee of the House of Representatives by Joseph B. Eastman, the Federal Coordinator of Transportation.*

In the form originally introduced in the House, H.R. 6249, the Eastman bill, contained new valuation guidelines, but did not explicitly entrust the responsibility of valuation to the Commission. More specifically, under the Eastman bill, the final paragraph of subsection (e) of Section 77 would have read as follows:

> "For the purposes of any determination in proceedings under this section to which the fair valuation of any property used in railroad operation may be necessary . . . such valuation shall be determined on a basis which will give due consideration to the earning power of the property, present and prospective, and all other relevant facts." (Hearings, p. 8)

As the hearings before the House Judiciary Committee progressed, it became apparent that the Committee doubted the wisdom of leaving valuation in any way or in any degree in the hands of the reorganization court. After hearing most of the testimony, the Chairman of the Committee (Congressman Sumners) indicated his desire to give the Commission exclusive jurisdiction over the issue of valuation. He posed two questions of a witness.

> "I want to ask you if you believe that it could be constitutionally and practically arranged that the

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* See H.R. Rep. No. 1283, 74th Cong. 1st Sess. 1 (1935); S. Rep. No. 1336, 74th Cong., 1st Sess. 2 (1935); *Hearings on H.R. 6249, House Committee on the Judiciary*, 74th Cong., 1st Sess. 13 (1935). The transcript of the hearings before the House Judiciary Committee is hereinafter cited as simply "Hearings."

valuation in these proceedings be fixed by the Interstate Commerce Commission.

• • •

"... The Government has an agency that it depends upon and generally has depended upon to deal with a very difficult question, namely, the value of the property of these common carriers. It is an unusual situation, and the ordinary processes of the courts in procuring evidence with regard to fact would not work in that sort of a situation.

"Now, in view of that extraordinary situation, of the extraordinary difficulty involved and the fact that this agency of the Government is available, and in view of the general difficulty of finding value, do you or do you not think that this proposed amendment could be so worded that in effect the determination of value would be through the instrumentality of this Governmental agency, the Interstate Commerce Commission rather than through the ordinary processes which the Courts exercise in inquiring into such facts?" (Hearings at 249.)

The witness, a Mr. R. C. Fulbright,* answered as follows:

"My answer is 'yes', and my suggestion there was that the determination should be left to the Interstate Commerce Commission, and that that determination should stand on review in the courts if the finding was based upon substantial evidence and if there be no misapplication of the law." (Hearings at 249.)

The colloquy continued as follows:

"The Chairman. Let us take a given case. Here is a specific case of reorganization, and a determination of value by the Commission is made. Somebody does not like that determination, and if somebody who does not like that determination has the power to upset it in the court, of course then the determina-

* Mr. Fulbright, appearing on behalf of stockholder interests, described himself to the Committee as an attorney who had practiced "for something more than 25 years . . . before the Interstate Commerce Commission and in the Federal courts. . . ." (Hearings at 242)

tion of that value is not left to the Commission. It gives its opinion to the court, as a basis for proceeding, but the final determination would be left to the court.

"Then how would the court proceed, in event such a situation should occur?

"Mr. Fulbright. My proposal is to leave that determination finally to the Commission, except where it has arbitrarily exercised its power.

"The Chairman. You would go into court and challenge that determination on the ground that it had been an arbitrary determination. Then how would you proceed after that?

"Mr. Fulbright. I would have to show the record that was made before the Commission and I would have to show from that record made before the Commission that there was no evidence to support the finding that it made, or I would have to show that the Commission had ignored the plain mandate of the law with respect to valuation.

* * *

". . . That is the practice in the case of appeals from rate orders made by the Interstate Commerce Commission. Some of us have been through a great many of those cases, and there is imparted a finality to the finding of the Commission because of its expert knowledge of that subject, which the courts will not review; that is, they will not substitute their discretion for the discretion of the Commission. The discretion of the Commission there is final.

"But if there has been an arbitrary exercise of that power, or if there has been a plain violation of the mandates of the law in reaching that determination, then we might attack it and have it enjoined or set aside, but as to the exercise of a discretionary power, and, after all, as was pointed out here, when you are fixing a prospective value you are exercising a discretionary power, and it seems to me that this bill should go a little further and make that finding of the Commission final, subject to the limitations that I have referred to here.

"What I am afraid of is that under this bill we would have to try the whole thing over again in the court, and I do not think that that ought to be done." (Hearing at 250.)

Shortly thereafter, Mr. Eastman's counsel, Leslie Craven, Esq., who had drafted the Eastman bill being considered by the Committee, offered a change in subsection (e) of the revised Section 77 which made it clear that valuation is a matter for the Commission. His new language was as follows:

> "If the plan certified by the Commission to the Court as provided in subsection (d) hereof is based upon the premise that it need not be submitted to any class of stockholders or creditors because of the insolvency of the debtor or because the equity or interests of such class of stockholders or creditors have no value or because* the plan requires the valuation of all or any portion of the debtor's property for any purpose, *the Commission shall determine such value and certify the same to the court in its report on the plan.*" (Hearings at 317; emphasis supplied.)

The House Judiciary Committee revised the "Craven Amendment" to make it more concise, and included the revised version in the final bill as the first sentence of the final paragraph of subsection (e), reading as follows:

> "If it shall be necessary to determine the value of any property for any purpose under this section, *the Commission shall determine such value and certify the same to the court in its report on the plan.*"**

The underscored portion of this language is identical to the underscored portion of the language of the amendment offered by Mr. Craven. No further changes were made in the language on the House floor or in the Senate.

Thus, the legislative history is specific and certain in demonstrating that the House Judiciary Committee was both informed and purposeful in amending the pending bill to provide in the last paragraph of subsection (3) for valuation determinations to be made exclusively by the Commission, subject to limited judicial review.

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* Presumably the word "if" was intended rather than "because".

** Section 77(e) of the Bankruptcy Act, 11 U.S.C. § 205 (emphasis added).

CHART OF RAILROAD ABANDONMENTS AND DISCONTINUANCES

I.C.C. DECISIONS SINCE JANUARY, 1960 THAT HAVE BEEN REVIEWED BY FEDERAL COURTS

Name of Railroad (Application Granted Except as Noted)	1. Time Interval	2. Nature of Application*	3. States Involved	4. States, State Agencies and/or Municipalities Protesting	5. Population of Area of Cities Served	6. Passengers or Carloads Carried	7. Mileage	8. Net Income or (Deficit) of System	9. Annual Revenue of Discontinued or Abandoned Line	10. Net Income or (Deficit) of Discontinued or Abandoned Line
Chicago & N.W. Ry. (Creston Grain) 317 I.C.C. 207 (1961), complaint dismissed sub nom. Creston Grain & Lumber Co. v. United States, 214 F. Supp. 840 (D. Neb. 1963)	6 Years 8 Mos. (filed 7/56)	1	Nebraska	Nebraska State Ry. Commission	Scribner 1,021 R Newman Grove, Neb. 880 R	1958: 558 carloads 1958: 5 passengers	65.5 miles	1958: $2.8 million M 1959: ($2.9 million M)	1958: $167,000 1959: $151,000	1958: ($22,000) 1959: ($103,000)
Chicago, N.S. & M. Railway (2) 317 I.C.C. 191 (1962), complaint dismissed sub nom. Illinois v. United States, 213 F. Supp. 83 (N.D. Ill. 1962) aff'd 373 U.S. 378 (1963) rehearing denied 374 U.S. 858 (1963)	4 Years 11 Mos. (filed 6/58)	1	Illinois, Wisconsin	Illinois Commerce Commission	Chicago 3.5 million Milwaukee 741,000	1960: 5.1 million passengers	106 miles	1959: ($399,000) 1960: ($468,000) 1961: ($540,000)	Passenger Revenue year ending 5/31/61: $4.7 million	1959:($399,000) 1960:($468,000) 1961:($540,000)
Southern P. Co. (South Line) 312 I.C.C. 685 (1961), complaint dismissed sub nom. Arizona v. United States; 220 F. Supp 337 (D. Ariz. 1963)	3 Years 10 Mos. (filed 7/59)	1 (of South line only)	Arizona, New Mexico	State Corporation Commissions of Arizona and New Mexico, Board of Supervisors of Cochise County, Municipalities of Bisbee, Tombstone & Douglas, Arizona	Douglas: 11,925 R Bisbee: 9,914 R	1958: local passengers 318; in transit 11,569 passengers 1958: 2,995 carloads	232.8 miles	1958: $50.9 million M	Not Available	1958:($599,000)
Central of Georgia Ry. 317 I.C.C. 184 (1961 complaint dismissed sub nom. Burke County v. United States, 206 F. Supp. 586 (S.D. Ga. 1962)	2 Years 10 Mos. (filed 9/59)	1	Georgia	Burke County; City of Waynesboro, Screven County, City of Sylvania	Waynesboro 5,359 R Sylvania 3,469 R	Not Available	2 lines totalling 77 miles (A) 36 (B) 41	1957: Central of Georgia $1.8 million M 1958: $1.5 million M	1957: (B) $53,000	1957: (B) ($52,000)
Fort Dodge, D.M. & S. Ry. 312 I.C.C. 709 (1961), complaint dismissed sub nom. Moeller v. I.C.C., 201 F. Supp. 583 (S.D. Iowa 1962)	1 Year 10 Mos. (filed 3/60)	3	Iowa.	Town of Lehigh; Iowa State Commerce Commission	880 (Town of Lehigh)	1959: 396 carloads	5.5 miles	$31.6 million $22.3 million 1957-1958	Not Available	1957:($19,000) 1958:($32,000) 1959:($30,000)

(1) Application denied in part. Figures relate to portion of line as to which abandonment was authorized.

(2) I.C.C. deferred issuing Final Order for a one year period in an effort to ascertain whether railroad's operations might be continued feasibly.

*KEY TO ABANDONMENT APPLICATIONS

1. Total Abandonment
2. Abandonment of Passenger Operations
3. Abandonment of Freight Operations
4. Discontinuance of Passenger & Freight Operations
5. Discontinuance of Passenger Operations
6. Discontinuance of Freight Operations

P 1960 U. S. Census Figures (Cited in Rand McNally 1968 Commercial Atlas and Marketing Guide)

M Moody's 1968 Transportation Manual

CHART OF RAILROAD ABANDONMENTS AND DISCONTINUANCES

I.C.C. DECISIONS SINCE JANUARY, 1960 THAT HAVE BEEN REVIEWED BY FEDERAL COURTS

Name of Railroad	1. Time Interval	2. Nature of Application*	3. States Involved	4. States, State Agencies and/or Municipalities Protesting	5. Population of Area of Cities Served	6. Passengers or Carloads Carried	7. Mileage	8. Net Income or (Deficit) of System	9. Annual Revenue of Discontinued or Abandoned Line	10. Net Income or (Deficit) of Discontinued or Abandoned Line
(Application Granted Except as Noted) (Continued)										
New York, S. & W. R.R. (3) --I.C.C.-- (1961), rev'd 200 F. Supp. 860 (D. N.J. 1961) rev'd sub nom. New Jersey v. New York, S. & W. R.R. 372 U.S. 1 (1963)	2 Years 2 Mos. (filed 12/60)	2 (4)	New Jersey	State of New Jersey & New Jersey State Board of Public Utility Commissioners	North Bergen, N. J. 42,387 R	April, 1959: Daily average of 928 passengers	37.9 miles	1958: ($621,000)M	Not Available	1958:($45,000) for 254 days
Southern Ry. 317 I.C.C. 255 (1962) rev'd sub nom. North Carolina v. United States, 210 F. Supp. 675 (M.D. N.C. 1962) rev'd sub nom. Southern Ry. v. North Carolina 376 U.S. 93 (1964). See also 118 S.E. 2d 21 (N.C. 1961)	2 Years 10 Mos. (filed 4/61)	2	North Carolina	State of North Carolina, North Carolina Utilities Commission	Durham, North Carolina 78,302 R	For year ending 5/59: 16,583 farepayers; 18,000 total travelers	129 miles	1959: $33.1 million	1959:$54,000	1959:($142,000)
Northwestern P. R.R. (5) 320 I.C.C. 19 (1963), complaint dismissed in 228 F. Supp. 690 (N.D. Cal. 1964) aff'd 379 U.S. 132 (1964) rehearing denied 379 U.S. 984 (1965)	3 Years 3 Mos. (filed 8/61)	3	California	California; California Public Utilities Commission & several cities	Tiburon 1,500 R	1959: 10,224 carloads 1960: 7,948 carloads	2.47 miles	1959: Net Railway Operating Income $1.3 million 1960: $272,000	Not Available	Not Available
Chicago & N.W. Ry. (Mankato) (6) 317 I.C.C. 21 (1962), complaint dismissed sub nom. Minnesota v. United States, 238 F. Supp. 107 (D. Minn. 1965)	3 Years 3 Mos. (filed 10/61)	5	Illinois, Minnesota, Wisconsin	Minnesota Railroad & Warehouse Commission; Wisconsin Public Service Commission, Numerous Communities	Chicago 3.5 mil.; Milwaukee 741,000	1960: 205,000 (A) passengers; 138,500 (B) passengers	(A) Chi.-Minn. 419 miles; (B) Chi.-Mankato, Minn. 445 miles	1959: $2.9 million M 1960: $7.2 million M	Not Available	1959:($1.7 million) 1960:($2.2 million)

(3) Dismissed for Lack of Jurisdiction.

(4) New York, S. & W. R. R. only operates passenger trains.

(5) Application Denied.

(6) I.C.C. deferred issuing Final Order for a one year period in an effort to ascertain whether railroad's operations might be continued feasibly.

CHART OF RAILROAD ABANDONMENTS AND DISCONTINUANCES

I.C.C. DECISIONS SINCE JANUARY, 1960 THAT HAVE BEEN REVIEWED BY FEDERAL COURTS

Name of Railroad	1. Time Interval	2. Nature of Application*	3. States Involved	4. States, State Agencies and/or Municipalities Protesting	5. Population of Area of Cities Served	6. Passengers or Carloads Carried	7. Mileage	8. Net Income or (Deficit) of System	9. Annual Revenue of Discontinued or Abandoned Line	10. Net Income or (Deficit) of Discontinued or Abandoned Line
(Application Granted Except as Noted) (Continued)										
Rutland Ry.(7) 317 I.C.C. 393 (1962), complaint dismissed sub nom. Bhd of Locomotive Engineers v. United States, 217 F. Supp. 98 (N.D. Ohio 1963)	1 Year 5 Mos. (filed 12/61)	1 (8)	New York, Vermont	New York State Office of Transportation; Vermont Public Service Commission; City of Rutland, Vermont	Total Population served 145,000	Carloads terminating on line: 1956:17,171 1957:15,225 1958:13,827 1959:13,331	331.7 miles	1956: $453,000M* 1957: $299,000M* 1958: $155,000M* 1959: $46,000M*	1956: $5.2 million 1957: $5.1 million 1958: $4.6 million 1959: $4.6 million	1956: $453,000 1957: $299,000 1958: $155,000 1959: $46,000 1960:($306,000) 1961:($246,000)
Pennsylvania R.R. --I.C.C.-- (1962), complaint dismissed in Sludden v. United States, 211 F. Supp. 150 (M.D. Pa. 1962); Pennsylvania R.R. v. Sharfsin, 215 F. Supp. 493 (M.D. Pa. 1963) (action to prevent Pennsylvania P.U.C. from enjoining discontinuance), 240 F. Supp. 233 (M.D. Pa. 1965) (injunction granted) vacated sub nom. Pennsylvania Public Utilities Comm'n. v. Pennsylvania R.R., 382 U.S. 281 (1965); injunction reissued F.Supp.---, aff'd 369 F.2d 276 (3rd Cir. 1966) cert. denied 386 U.S. 982 (1967) rehearing denied 386 U.S. 1043 (1967)	5 Years 2 Mos. (filed 1/62)	5	Maryland, Pennsylvania	Pennsylvania Public Utilities Commission	Harrisburg; Pennsylvania 79,697 R Hagerstown; Maryland 36,660 R	Not Available	Not Available	1957: $19.1 million M 1958: $3.5 million M 1959: $7.3 million M 1960: $7.8 million M	Not Available	Not Available
Southern P. Co. (Santa Clara County) 320 I.C.C. 278 (1963) complaint dismissed sub nom. Humphreys v. United States, 228 F. Supp. 510 (N.D. Cal. 1964)	2 Years 1 Month (filed 3/62)	1	California	California Public Utilities Commission; Santa Clara County, Town of Los Gatos; City of Los Altos	Santa Clara County 642,000 R	170 people (each direction) served on daily basis: 1960: 17 carloads annually 1961: 31 carloads annually	6.3 miles	1960: $6.50 million M 1961: $8.79 million M	1960: $75,000 1961: $69,000	1960:($21,000)(9) 1961:($21,000)

(7) The Brotherhood sought to have the I.C.C. order set aside on the grounds that it did not include labor protective conditions.

(8) At time of litigation, only freight service in operation.

(9) Exclusive of Avoidable Capital Losses.

M* Moody's 1961 Transportation Manual

CHART OF RAILROAD ABANDONMENTS AND DISCONTINUANCES

I.C.C. DECISIONS SINCE JANUARY, 1960 THAT HAVE BEEN REVIEWED BY FEDERAL COURTS

Name of Railroad	1. Time Interval	2. Nature of Application*	3. States Involved	4. States, State Agencies and/or Municipalities Protesting	5. Population of Area of Cities Served	6. Passengers or Carloads Carried	7. Mileage	8. Net Income or (Deficit) of System	9. Annual Revenue of Discontinued or Abandoned Line	10. Net Income or (Deficit) of Discontinued or Abandoned Line
(Application Granted Except as Noted) (Continued)										
Feather River Ry. (10) 320 I.C.C. 417 (1964), complaint dismissed sub nom. California v. United States, 255 F. Supp. 607 (N.D. Cal. 1965)	4 Years 1 Month (filed 4/62)	3	California	California (seeking abandonment)	Land & Craig, California (figures not available)	1960: 20 cars per week 1961: 39 cars per week	6 miles	Not Available	Not Available	Not Available
Chicago & N.W. Ry. (Randolph) 324 I.C.C. 405 (1965) complaint dismissed sub nom. Nebraska ex rel. Nebraska State Ry. Comm'n v. United States, 255 F. Supp. 718 (D. Neb. 1966)	3 Years (filed 6/63)	3	Nebraska	Nebraska State Railway Commission	Bloomfield; 1,349 R 1,063 R	1962: 256 cars	Bloomfield-Randolph 22.47 mi. Randolph-Laurel 14.54 mi. Total 37 miles	1962: ($1.8 million) M	Not Available	1962:($23,000)
Chicago, R.I. & P. R.R. 324 I.C.C. 411 (1964), complaint dismissed sub nom. Tri-S Corp. v. Interstate Commerce Comm'n, 253 F. Supp. 715 (S.D. Iowa 1966)	2 Years 7 Mos. (filed 9/63)	3	Iowa	Iowa State Commerce Commission	Walnut 777 Shelby. 533	220 carloads annually	14.8 miles	1961: $16. 1 million M 1962: $16.2 million M	Not Available	1961:($11,000) 1962:($8,000) 1963:($2,000) (first 6 mos.)
Union P. R.R. (11) 320 I.C.C. 493 (1964), complaint dismissed sub nom. California v. United States, 258 F. Supp. 950 (N.D. Cal. 1966)	2 Years 7 Mos. (filed 11/63)	5	California, Nevada, Utah	California, California Public Utilities Commission, Nevada & Utah Regulatory Agencies, Cities of Ogden and Las Vegas	Los Angeles 2.6 million Salt Lake City 189,500	1961-1962: 70 passengers (trip off peak) 140 passengers (trip off peak)	821 miles	1961: $67.7 million M 1962: $82.5 million M	1961: $2.7 million 1962: $2.8 million	1961:($136,000) 1962:($59,000)
Boston & Maine Corp. (Boston) 324 I.C.C. 418 (1965), complaint dismissed sub nom. New Hampshire v. Boston & Maine Corp., 251 F. Supp. 421 (D. N.H. 1965)	1 Year 6 Mos. (filed 6/64)	5	Massachusetts, New Hampshire, Vermont, Maine	Vermont, New Hampshire, Massachusetts Department of Public Utilities, Maine Public Utilities Commission, New Hampshire Public Utilities Commission, Numerous Towns & Cities	Boston, Mass. 697,197 R Portland, Maine 72,566 R	1962: 5.3 million passengers	Not Available	1962: $2.9 million M 1963: $2.9 million M	1962: $4.6 million 1963: $5.0 million	1962:($3.8 million) 1963:($2.2 million) Net operation deficit

(10) Application denied in part.

(11) Elimination of passenger trains operating between Ogden, Utah and Los Angeles.

CHART OF RAILROAD ABANDONMENTS AND DISCONTINUANCES

I.C.C. DECISIONS SINCE JANUARY, 1960 THAT HAVE BEEN REVIEWED BY FEDERAL COURTS

Name of Railroad	1. Time Interval	2. Nature of Applications	3. States Involved	4. States, State Agencies and/or Municipalities Protesting	5. Population of Area of Cities Served	6. Passengers or Carloads Carried	7. Mileage	8. Net Income or (Deficit) of System	9. Annual Revenue of Discontinued or Abandoned Line	10. Net Income or (Deficit) of Discontinued or Abandoned Line
(Application Granted Except as Noted) (Continued)										
Washington & O.D. R.R. --I.C.C.--, Dkt No. 23492 (1968), complaint dismissed sub nom. Washington & Old Dominion Users Ass'n v. United States, --F. Supp.--, Civ. Action No. 4703-A (E.D. Va. Decided 7/25/68)	3 Years 6 Mos. (filed 2/65)	1 (12)	Virginia	Washington Metropolitan Area Transit Authority	Alexandria, Virginia 163,401 R Arlington, Virginia 91,023 R	1960: 10,398 carloads 1964: 8,999 carloads	47.89 miles	1960: ($19,177) 1964: ($55,880)	1960: $638,000 1964: $517,000	1960:($19,000) 1964:($56,000)
Boston & Maine Corp. (Springfield) 328 I.C.C. 594 (1967), complaint dismissed sub nom. Vermont v. Boston & Maine Corp., 269 F. Supp. 80 (D. Vt. 1967)	1 Year 3 Mos. (filed 2/66)	5	Massachusetts and Vermont	Many Vermont & Massachusetts Governmental Authorities	Springfield, Massachusetts 174,463 R White River Junction, Vermont 2,600 R	45 passengers per day	123 miles	1965: ($578,000)	1965: $578,000	1965:($169,000)

(12) At time of litigation only freight service in operation.